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ABSTRACT

This study examined the role of subcontractors and consultants in California's Employment Training Panel (ETP) program. Methods included interviews, focus groups, a phone survey, and a survey of projects without subcontractors. Results indicated that the market in which administrative and training consultants sell their services to employers is inefficient, with prices ranging significantly above the competitive and low product quality. Over the last 2 fiscal years, the total market for ETP subcontractors and consultants was $31-35 million or 36-40 percent of all money spent on ETP training. ETP subcontractors and consultants were categorized into seven subgroups based on company size and services provided: full-service companies; public or nonprofit agencies; hollow companies; niche trainers; freelance project administrators; freelance packager; and project doctor. Subcontractors and consultants offered benefits and risks to ETP. They played a major role in marketing but were aggressive. Many had expertise in developing projects, but some driven by profit incentives tried to shape projects most profitable to them. They could provide high quality state-of-the-art training but had an incentive to reduce the quality and hence its costs. They understood policy but tended to manipulate the process for gain. Recommendations were made to align the incentives that drive subcontractors and consultants with ETP's larger objectives and to transform the market into an orderly efficient one. (A report on market estimates is appended.) (YLB)

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ETP and Its Subcontractors and Consultants

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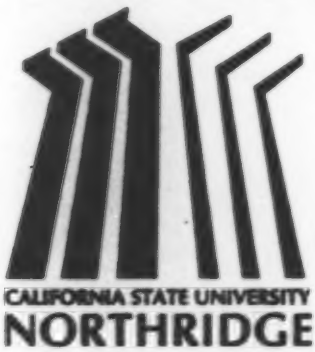

College of Business Administration and Economics

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Executive Summary

Overview

In June 1996 the Employment Training Panel (ETP) contracted with a team of researchers in the College of Business Administration and Economics at California State University, Northridge to conduct a study of the role of consultants in the ETP program. The study was designed to answer the following question:

What should Panel policy be towards subcontractors and consultants[1] who provide administrative and training services to employers on ETP proposals and projects?

Method

To answer the question posed above, the study team examined the role of subcontractors and consultants and analyzed a wide array of data. Project methods included interviews with Panel members and senior staff; focus groups with subcontractors, regional staff and employers who used subcontractors; interviews with employers and subcontractors and consultants from a representative sample of recent projects; and an empirical analysis of recent projects with and without subcontractors.

Market for ETP Consultants and Subcontractors

Looking broadly at the results of our research, we find that the market in which both administrative and training subcontractors and consultants sell their services to employers is best described as an inefficient market - one in which prices range significantly above the competitive level and the product quality may be low.

The inefficient market for ETP services has four defining characteristics each of which has important implications for ETP. Each characteristic is described below.

- *Low levels of information among buyers:*

This study found surprisingly low levels of information available about subcontractors and consultants. This is due in large part to the fact that half the employers do not shop for subcontractors and consultants. Our survey found that only half the employers considered more than one subcontractor or consultant.

- *Easy entry and exit, multiple paths into the market:*

Over the past three years, there have been approximately 300 subcontractors and consultants working on ETP projects, constantly coming in and out of the ETP market.

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[1] Throughout the report we will refer to individuals and companies who have an official subcontract on an ETP project as *subcontractors*. We will refer to individuals and organizations who have performed work on an ETP proposal or contract without an official subcontract as *consultants*.

- *Limited likelihood of repeat purchases:*

For most employers, conducting an ETP project is a one time event. It is unlikely that an employer will be looking for another ETP project subcontractor or consultant again soon. Hence, subcontractors and consultants do not need to be as concerned about repeat business as other types of service providers who need customers to make repeat purchases to be successful.

- *Third party funding:*

A problem unique to the hiring of ETP subcontractors and consultants is the fact that employers may not treat ETP money like their own money.

Results

We estimate that the total size of the market for subcontractor and consultant services generated by ETP projects in fiscal years 1995 and 1996 was between $31,191,000 and $34,855,00 or between 36% and 40% of all funds spent on ETP training.

ETP subcontractors and consultants can be broken into seven subgroups based on the size of the company and the services they provide:

- *Full Service Companies (20%):* These companies provide a full range of ETP services including proposal development, administration, and a range of training programs.

- *Public or Non-profit Agencies (5%):* This category includes a wide range of public and private non-profit agencies.

- *Hollow Companies (25%):* These companies market a full range of ETP services but are in fact small companies that subcontract out for most of the services they provide to a network of other small firms or individuals.

- *Niche Trainers (20%):* These companies are small highly specialized training companies, usually with few employees. They provide specialized training in narrow market niches.

- *Free-lance Project Administrators (20%):* This group is made up of individuals and occasionally partnerships, who primarily provide administrative services, often one project at time.

- *Free-lance Packager (10%):* This group is made up of individuals and occasionally partnerships whose primary business is seeking out companies who may be interested in ETP training, and helping them develop a proposal that will be accepted by the Panel.

- *Project Doctor (<1%):* Much like Hollywood script doctors, these subcontractors and consultants often become involved in a project after it has run into trouble. They tend to specialize in solving administrative problems and negotiating with ETP.

Overall, most employers surveyed believed the subcontractors and consultants they hired played a key role in the success of their project. Most employers remain satisfied with the subcontractors and consultants they choose. There does seem to be a problem group of subcontractors and consultants however. We estimate from this survey that between 10% and 20% of the subcontractors and consultants on the projects we studied did not perform up to the expectations of the employer.

Interestingly, when we cross-tabulated the evaluation of the subcontractor with whether or not the employer considered more than one subcontractor, we found that all the employers who were dissatisfied had not shopped for a subcontractor, but considered only one. This indicates to us that a lack of information about alternatives does lead to less satisfaction with the choice of subcontractor.

Clearly the most important benefit employers got from using a subcontractor was help in managing what the employers saw as the complex ETP process. Fifty-one percent of the employers gave the benefit related to managing the program as the most significant benefit received from using a subcontractor, while only 30% identified the benefit related to training as the most significant. Fully one-quarter of the employers reported that help keeping track of complex ETP "rule and policy changes" was the most significant benefit. An additional 17% said "handling ETP paper work the employer's staff could not," and 11% believed a subcontractor" made it easier to get ETP to approve the project." Conversely, 19% said "provide trainers employer did not have in-house" and 11% reported "designed custom training" as the most significant benefit.

Impact of Subcontractors and Consultants on ETP

Since subcontractors' and consultants' most severe critics will admit some subcontractors and consultants provide some valuable services and since the most ardent defenders of subcontractors and consultants admit there are problem subcontractors and consultants out there, we have organized our summary around various aspects of the ETP program and attempted to demonstrate how subcontractors and consultants offer a benefit to ETP, and contrast this with the risks that they pose to the program.

Marketing

Benefits: This is the area with the strongest consensus. All the groups we interviewed recognized that subcontractors and consultants play a major role in marketing ETP. One senior ETP manager estimates that they are responsible for bringing in as much as 80% of all ETP projects.

Risks: Subcontractors and consultants are aggressive, they will test the boundaries or push the envelope on ETP policies to try and qualify projects which are marginal, look for loopholes to slip through projects that may conform to the letter of ETP policy but not to the spirit of ETP priorities.

Developing Projects

Benefits: Many of the training and management companies that do ETP subcontracting and consulting have a wealth of specialized expertise in skill areas, in industries, and managing projects. Good subcontractors and consultants help companies do effective needs assessment that links training to larger corporate goals and they deliver high quality state-of-the-art training that is customized for the individual companies.

Risks: Some subcontractors and consultants driven by powerful profit incentives will try to shape projects to be most profitable for them.

Managing Projects

Benefits: Effective subcontractors and consultants can save monitoring staff time by knowing ETP procedures and providing needed documentation and information promptly. Subcontractors help implement ETP policy changes by tracking changes and keeping employers up-to-date.

Risks: Subcontractors and consultants may distort ETP policies and undermine effectiveness, by testing boundaries, seeking loopholes in order to serve existing clients or generate more profits.

Delivering Training

Benefits: Today, even relatively large companies may have few or no in-house trainers. Training subcontractors and consultants can provide ETP programs with high quality state-of-the art curricula and trainers. Without training subcontractors and consultants, companies without an in-house training capacity simply could not participate in ETP.

Risks: Training subcontractors and consultants have an incentive to reduce the quality of training and hence its costs in order to reap larger profits.

Policy Process

Benefits: Subcontractors and consultants spend a lot of time working with employers and the ETP process, hence they have extensive and detailed knowledge of how ETP policies are operationalized in the field. Tapping this understanding, as this project tried to do, could provide the Panel with valuable information for policy development.

Risks: Once again, as profit driven entities, subcontractors and consultants are likely to try to manipulate the policy process solely for their own gain.

Recommendations

Our recommendations have two overarching goals: (1) to align the incentives that drive subcontractors and consultants with the larger objectives of the Panel and (2) to transform the inefficient market for ETP subcontractors and consultants into an orderly efficient market. To accomplish these goals, we recommend that the Panel act to increase the amount of information available about subcontractors and consultants and take other steps to help employers make informed choices about subcontractors and consultants.

1. **The Panel should provide employers with an easily accessible system of consumer information on subcontractors.**

We recommend that the system include the following types of information:

- Name and contact information for all subcontractors who have been listed as subcontractors on ETP projects in the last three years.
- The names and contact information of ETP clients each subcontractor has had over the last three years.
- Descriptive information of the subcontractor's work on the projects, including: project size, industry, type of training or administrative services delivered.
- Information on the fees paid to subcontractors for services provided including: proposal development, administration, and training.
- Percent of planned trainees who completed training on each project.
- A rating of the subcontractor's performance by the employer.
- Subcontractor's attendance at recent ETP training sessions.

2. **The Panel should develop a consumer guide to help employers choose subcontractors and consultants wisely.**

3. **The Panel should provide semi-annual training for subcontractors and post attendance on the information system.**

4. **The Panel should work with subcontractors to get advice and insights about issues related to ETP.**

5. **The Panel should consider how subcontractors and consultants shape the consequences of ETP policies, and conversely how ETP policies drive subcontractor or consultant behavior when developing policies.**

Introduction

In June 1996 the Employment Training Panel (ETP) contracted with a team of researchers in the College of Business Administration and Economics at California State University, Northridge to conduct a study of the role of subcontractors and consultants in the ETP program. The study was designed to answer the following question:

What should Panel policy be towards subcontractors and consultants who provide administrative and training services to employers on ETP proposals and projects?

Managing the role of subcontractors and consultants[1] in ETP projects has been a continuing challenge for the Panel. The Panel funded an earlier project on the role of subcontractors (previously including and referred to as consultants) in 1989[2] indicating that the role of subcontractors and consultants has been controversial for at least that long. Panel staff are concerned that subcontractors and consultants may undermine the effectiveness of ETP in a variety of ways which we discuss later. From our perspective, it seems that ETP staff, close observers of ETP, and even the subcontractors and consultants themselves would agree that there are high quality, effective subcontractors and consultants who enhance the delivery of ETP training, and at the same time, there are problem subcontractors and consultants who undermine the effectiveness of Panel policies and training. This view is supported by the results of the earlier study. For us, the issue for the Panel is how to manage subcontractors and consultants in the ETP program, so that they contribute to the larger objectives of ETP.

To answer the question posed above, the study team examined the role of subcontractors and consultants and analyzed a wide array of data. Project methods included interviews with Panel members and senior staff; focus groups with subcontractors, regional staff and employers who used subcontractors; interviews with employers and subcontractors and consultants from a representative sample of recent projects; and an empirical analysis of recent projects with and without subcontractors. (The study's specific methods are reviewed in detail in a later section.)

We begin by reviewing the results of the earlier study, and presenting our project's objectives in more detail. We then review the methods we employed. Next, we present our central finding which is that both employers and subcontractors and consultants operate in a "Inefficient Market" which has created many of the problems identified with subcontractors and consultants. We estimate the size of the markets for subcontractors and consultants and describe who the subcontractors are and where they come from. We describe the mix of services provided by subcontractors and consultants. Then we turn our attention to the Panel and Panel staff's perception of the subcontractors and consultants, and the subcontractors' and consultants' view of the staff and Panel. We wrap up the results section with a complete review of the benefits and risks posed by subcontractors'

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[1] See page 2 for definition of subcontractor and consultant.

[2] Wilms, Wellford and Moore, Richard W. Brokering Government Services: An Analysis of Administrative Consultants and the California Employment Training Panel. Sacramento: Employment Training Panel, September 12, 1989.

and consultants' participation in the program. We conclude with a series of recommendations based on the concept of creating a more orderly and informed market for the selection of ETP subcontractors and consultants.

Perceived Problems with Subcontractors and Consultants

Many Panel staff members and some close observers of ETP have come to associate the participation of subcontractors and consultants in ETP with a variety of problems. Specifically some argue that the problem ETP has in having to disencumber a large percentage of the funds[3] it has contracted to expend is caused by subcontractors and consultants "over selling" employers, encouraging them to apply for more training then they can practically accomplish. A second criticism of subcontractors and consultants is that they encourage the participation of employers who have substantial regular training programs and whose workers are not really at risk of layoff to apply for ETP training, by selling ETP as "free government money." Subcontractors and consultants use their detailed knowledge of ETP procedures to get these proposals approved and ETP ends up subsidizing training that would have occurred anyway. There are accusations that some subcontractors and consultants have found ways to reap excessive profits. Excessive profits are generated by getting a naive employer to purchase a training program that is essentially an off-the-shelf curriculum, taught by low paid instructors, and then getting paid at ETP's fixed fees which assume more customized training and more expensive instructors, thereby reaping a large profit and producing little of value. Overall some individuals see these abuses by subcontractors and consultants as a threat to ETP's long-term survival.

Evaluating these concerns has been difficult for Panel members and staff. There are little systematic data on subcontractors and consultants and their practices. Many consultants work on ETP projects but do not sign and submit formal subcontracting agreements with ETP. Thus there is a substantial population of "hidden consultants" also known as "phantom consultants," and ETP knows even less about this group's behavior.

Before we proceed a note on terminology. Throughout the report we will refer to individuals and companies who have an official subcontract on an ETP project as *subcontractors*. We will refer to individuals and organizations who have performed work on an ETP proposal or contract without an official subcontract as *consultants*. We recognize that the same individuals or organizations may have been a "subcontractor" at one time and a "consultant" at another time.

Related Research

Any time government sets up a system to award contracts or grants, brokers who have special knowledge of the process, spring up to help applicants win the contracts and grants. We searched the published academic literature in the fields of political science, economics,

[3] Historically about 40% of the money ETP has awarded in contracts has not been spent on the contract, and thus disencumbered.

and public administration for previous policy studies on government policy towards these types of brokers. Surprisingly, we found none.

We begin our analysis of ETP subcontractors and consultants by reviewing the findings of the earlier study of subcontractors (previously all called consultants) cited before. It is important to note that this study looked exclusively at administrative subcontractors and did not consider training subcontractors.
The study had four primary conclusions[4]:

- there were no measurable differences between the characteristics of projects with and without subcontractors,
- Panel operations and regulations create the demand for subcontractors,
- most employers are satisfied with the subcontractors they chose,
- the positive impact of ETP training is the same on projects with and without subcontractors.

Based on their findings Wilms and Moore made five recommendations to the Panel[5]:

1. There is no evidence of a need to regulate subcontractors.
2. The Panel should closely monitor the costs and benefits of supporting administrative subcontractor costs.
3. Panel members should be aware that their own regulations govern the market for subcontractors.
4. Panel members and staff need to be scrupulous in their dealings with subcontractors.
5. The Panel should make clear to the business community that engaging subcontractors in no way implies an advantage in securing Panel funding.

Much has changed since this study was completed. ETP has increased its focus on economic development and gone to a policy of targeting basic industries only, by emphasizing training for businesses faced with out-of-state competition and training to support the State's export base. The size and complexity of the program has grown substantially. In turn, the number of subcontractors and consultants working in ETP projects has increased significantly.

Research Questions

Based on the Panel's history with subcontractors and consultants and the larger policy question posed above, we designed a study to answer the following research questions:

1. What are the characteristics of subcontractors and consultants who are involved in ETP contracts?
2. What roles do subcontractors and consultants play in the ETP process?
3. Why do some consultants prefer to remain hidden?

[4] Wilms and Moore, pg. 31.
[5] Wilms and Moore, pages 34-37.

4. How large is the market for ETP subcontractor and consultant services both open and hidden?
5. Why and how do employers choose subcontractors and consultants, and how do they evaluate the subcontractor's or consultant's performance?
6. What impact have subcontractors and consultants had on the ETP process?
7. What impact do subcontractors and consultants have on ETP policy?
8. How have other similar public agencies handled the issue of subcontractors and consultants?

Methods

To answer the questions posed above, we conducted individual in-person, and individual phone interviews with Panel members, and ETP executive staff. We conducted focus groups with ETP field staff, ETP subcontractors, and employers who had an ETP project in the last fiscal year (July 1995-1996). In addition, we conducted a phone survey of a sample of half the projects which reported using subcontractors that ended in FY 1996. In the survey, we interviewed both the employer and the primary subcontractor. We also surveyed all of the projects from the last fiscal year which did not report an official subcontractor to determine how many had used a consultant. We assembled a database of existing ETP data on projects that closed in FY 1994-95 and 1995-96 to estimate the size of the subcontractor and consultant market and to describe the differences between projects with and without subcontractors.

Interviews

- *Panel Member Interviews*

The purpose of Panel member interviews was to obtain their views on the role subcontractors and consultants play in the ETP program and on policy issues related to subcontractors and consultants.

Panel members answered questions about past and present roles of subcontractors and consultants in the ETP program; the impact subcontractors and consultants have had on the development of proposals, delivery of training, and shaping of ETP policy; what problems the Panel has encountered with subcontractors and consultants; Panel members' views on subcontractors and consultants and what the Panel believes the policy for subcontractors and consultants should be.

We interviewed six of eight Panel members, individually by phone, between October 1996 and November 1996.

- *ETP Executive Staff*

The purpose of executive staff interviews was to obtain their views on the role subcontractors and consultants play in the ETP program, and on policy issues related to subcontractors and consultants.

Executive staff answered questions about past and present roles of subcontractors and consultants in the ETP program; the impact subcontractors and consultants have had on the development of proposals, delivery of training, and shaping of ETP policy; what problems the executive staff has encountered with subcontractors and consultants; Executive staff's views on subcontractors and consultants and what they believe Panel policy should be for subcontractors and consultants.

We interviewed all ETP executive staff members, individually in person, at ETP Sacramento offices, in August 1996.

Focus Groups

- *ETP Field Staff*

The purpose of the ETP staff focus groups was to collect information about the staff's experience with subcontractors and consultants and their assessment of the impact of subcontractors and consultants on ETP programs.

ETP field staff discussed how the role of subcontractors and consultants has evolved over time, how subcontractors and consultants help ETP achieve its objectives, and what each of the various types of subcontractors and consultants has contributed to the success (or failure) of projects. Staff also discussed at length problems they had encountered working with subcontractors and consultants. They also made suggestions about how ETP can better manage subcontractors and consultants.

We conducted two focus groups with ETP field staff in the San Mateo office (six members) and the North Hollywood office (eight members).

- *Subcontractors*

The purpose of the subcontractor focus groups was to collect subcontractors' views on their own work in general and their role in the ETP program, and to solicit ideas for improvements in the ETP program.

In the focus groups, subcontractors discussed their backgrounds, the various ways they obtain clients (for both ETP projects and others) and how they became involved in ETP projects. They spoke of the problems some subcontractors and consultants cause for ETP projects. Other topics included: fixed fees, agency agreements, risk sharing with employers, various ETP regulations and monitoring practices, the probable impact of the ETP policy that requires employers to reveal fees paid to consultants who help develop the proposal, and alternative policies for managing subcontractors and consultants in the ETP process.

We conducted two focus groups with ETP subcontractors, one with six subcontractors (of seven who were to be there) at the University Club on the California State University, Northridge campus, and one with seven subcontractors (of seven who were to be there) at

the San Mateo ETP office. Participants were chosen to be representative of the subcontractors in that region.

- *Employers with Subcontractors*

The purpose of the employer focus groups was to collect employers' views on the role their subcontractors played in specific ETP projects, and to solicit ideas for improvements in the ETP program.

In the focus groups, employers answered questions about how they first became involved with the ETP, why they used an ETP subcontractor, and how well the ETP project achieved their objectives. Other topics included: ETP regulatory demands, monitoring processes, ETP paperwork, and ways to manage subcontractors in the ETP program.

We conducted two focus groups with employers, one with two employers (of seven who were to be there) at the University Club on the California Sate University, Northridge campus, and one with three employers (of six who were to be there) at the San Mateo ETP office. Participants were chosen to be representative of employers in that region.

Phone Surveys

- *Sample*

We randomly selected half (36) of the projects that closed in FY 1996 that reported using a subcontractor on the project for a phone survey. We began by contacting the employer on the project. If the company was unreachable, had gone out of business or was a consortium project, we replaced the project with a second project.

In the employer interview, we asked the employer to identify the primary subcontractor on the project. We then interviewed the subcontractors. We completed interviews with 33 employers-a response rate of 94%, and 32 subcontractors-a response rate of 91%.

- *Interview Guides*

Interview guides including both structured and open-ended questions were developed by project staff based on the results of the focus groups. Drafts of the instruments were reviewed by ETP staff and refined.

The employer interview guide included questions about how employers first learned about ETP and why their ETP project was created, how they chose their ETP subcontractor and for which aspects and tasks of the project they used their ETP subcontractor. Other topics included: compensation for the subcontractor and opinions about a third-party rating system to provide employers information about the quality of subcontractors and consultants.

We used a similar approach to create an interview guide for the subcontractors. The interview guide included questions about their background and their company, their

relationship with the ETP employer, their marketing methods, their involvement in the ETP project, why the employer used them, and how they were compensated for the project. They also answered open-ended questions about why some consultants prefer to be paid outside the ETP contract and what they think about a third party-rating system for employers on subcontractors.

- *Analysis*

Data from the questionnaires were reviewed. Open-ended questions were categorized and coded. A statistical analysis of the data was completed.

Survey of Projects without Subcontractors

- *Sample*

We interviewed all employers from projects in fiscal year 1996 who did not report an official subcontractor. Of the 38 projects without a reported subcontractor, we were able to contact 37.

- *Interviews*

The purpose of the interviews was straightforward and we asked four simple questions: (1) had the employer used a consultant to prepare the ETP proposal? (2) had the employer used a consultant to administer the ETP project? (3) had the employer used a consultant to provide training for the project? (4) had the employer hired any employees to work on the ETP project?

- *Analysis*

Data from the survey were used to estimate the size of the consultant market.

Results

The Inefficient Market for ETP Subcontractors and Consultants

Looking broadly at the results of our research, we find that the market in which both administrative and training subcontractors and consultants sell their services to employers is best described as an "Inefficient Market.[6]" This is a market with prices often above the competitive level and with possible large variations in product quality.

One hallmark of efficient markets is widely-shared consumer information on the various sellers' prices and product qualities. Widely-shared information allows the consumers to comparison shop and to purchase where they obtain the best combination of price and quality. New and developing markets initially lack the information to identify the best deal and consequently prices and qualities may vary widely. But, as product price and quality

[6] See for example Jeffrey M. Perloff and Klaus T. van't Veld, Modern Industrial Organization, second edition, Harper Collins College Publisher, 1994, pp. 554 ff.

information becomes more widely available, the relatively high-priced, low-quality producers are unable to make sales, and disappear from these markets leaving the producers of the desired price/quality goods. Newcomers in this market will have to offer products with prices and qualities that meet or beat the existing producers, otherwise the new producers will not be able to sell in this market. The essential ingredient in an efficient market is the widespread information about the sellers, their locations, their prices, and product qualities.

Economists have investigated the effects of the absence of quality and price information on the functioning of markets and have found that information-limited markets operate inefficiently compared to information-rich markets. The absence of product quality information leads to lower-quality products dominating the market because the consumers who cannot distinguish variations in the quality of the product are not willing to pay a higher price for a higher quality product. The absence of a higher remuneration to the companies producing the higher quality products eventually drives those products from the market.

Limited price information can result in several market outcomes depending on the nature of the price information available. If consumers initially lack any price comparison information but can search for it among known sellers at a cost, the result is either an equilibrium price at the monopoly-level price or the absence of an equilibrium price altogether. The absence of an equilibrium price results from the incentive of sellers to raise prices above the competitive (efficient) level because consumers incur costs to search for a lower price. This means that the sellers who raise prices will not lose all of their sales and their profits will rise, continuing their incentive to raise prices further. This may lead other sellers, particularly new entrants, to cut prices from the monopoly level to gain entry and business. In this case, there is a dispersion of prices and individual sellers are constantly adjusting their prices. When a market has a mixture of informed and uninformed consumers it will produce a multi-price equilibrium with the informed consumers paying the competitive price and the uninformed shopping randomly, encouraging some sellers to price at the highest level that the uninformed consumer is willing to pay.

In a situation that closely parallels the ETP-generated market for consultants and subcontractors, if consumers are aware of some of the sellers but not others, the market is likely to have a full range of prices charged. Unfortunately, the prices charged will be unrelated to the qualities of the services; rather the price paid by any one customer will be more closely related to that customer's knowledge of other sellers' prices and the buyer's incentive to search out a good deal, along with the costs of doing so. Curiously, in this case, the entry of new sellers into the market can actually raise the average price charged by increasing the search cost for the customers.[7] Lowering the cost of searching for a lower-cost provider in these markets is likely to lead to a lower average price and less price dispersion.

[7] Usually seller's easy entry and exit from a market guarantee an efficient market and a competitive price because sellers who charge more than a competitive price will be punished by competition from new entrants and will lose virtually all of their sales and profits.

The inefficient market for ETP services has four defining characteristics each of which has important implications for ETP. Each characteristic is described below with its implications for ETP policy.

- *Low levels of information among buyers:*

This study, like the earlier study, found surprisingly low levels of information available about consultants and subcontractors. This is due in large part to the fact that half the employers do not shop for consultants and subcontractors. Our survey found that only half the employers considered more than one consultant or subcontractor. A third of the employers got their consultant or subcontractor through a cold call. Most employers evaluated consultants and subcontractors exclusively on information provided by the consultant or subcontractor. There is, in fact, no readily available data on consultant's or subcontractor's experience or price. Employers cannot open an industry publication or the yellow pages and find information on consultants' and subcontractors' prices and services listed side by side to help them choose wisely.

We also found that, as a business strategy, consultants and subcontractors try to develop niche markets and dominate them exclusively. For example, a consultant or subcontractor may specialize in TQM training for union manufacturers in one industry. If he or she can dominate the market, it discourages other consultants and subcontractors from attempting to enter the niche, which leaves employers in this sector with few alternatives and little information. This situation means that many employers will continue to make decisions to hire consultants and subcontractors with little objective information about their qualifications or their prices.

- *Easy entry and exit, multiple paths into the market:*

Over the past three years, there have been approximately 300 consultants and subcontractors working on ETP projects, constantly coming in and out of the ETP market. This is because it is very easy to enter the market for ETP consulting, and even easier to leave the market. Many consultants and subcontractors work on a single project and then never work on another. There is no license required, and no clear standards to direct employers to one consultant or subcontractor over another. The results of our survey, that follow this section, clearly show that ETP consultants and subcontractors come from a wide range of backgrounds. Some consultants and subcontractors enter the ETP market with extensive experience with ETP, some being former ETP staff. Some enter the field with long experience in management consulting or training. Others have little or no first-hand experience with ETP.

The consequence of these phenomena for ETP is that staff must contend with a constantly shifting array of consultants and subcontractors. While some consultants and subcontractors work on many projects over many years, most consultants and subcontractors are involved briefly and leave, or do ETP projects very sporadically. This

makes the development of on-going relationships and communication between ETP and the consultants and subcontractors difficult at best.

- *Limited likelihood of repeat purchases:*

For most employers, conducting an ETP project is a one time event. It is unlikely that an employer will be looking for another ETP project consultant or subcontractor again soon. Hence, consultants and subcontractors do not need to be as concerned about repeat business as other types of service providers who need customers to make repeat purchases to be successful. This in turn reduces the incentive to keep the customer satisfied. This phenomenon is less of a problem for consultants and subcontractors who provide non-ETP services to clients, since they do have a market for repeat business outside of ETP.

Also, since employers are likely to only choose an ETP consultant or subcontractor once, they lack experience, making them fairly unsophisticated consumers. Unless an employer has a contact at a similar company that has conducted an ETP project, or has a staff person who is familiar with ETP, they will have little opportunity to gain the information they need to evaluate consultant's or subcontractor's claims. Our survey data show that most employers are selecting a consultant or subcontractor without any objective information about the consultant's or subcontractor's performance.

- *Third party funding:*

A problem unique to the hiring of ETP consultants and subcontractors is the fact that employers may not treat ETP money like their own money. An employer who has not fully thought through the costs of training may perceive that ETP is paying all of the direct costs of training, and hence they may not be as vigilant in selecting a consultant or subcontractor or in driving down the price as the employer would be if spending money from the company's own budget. The analogy here would be an insured consumer whose car has been damaged in an accident and is allowed to select any repair shop he/she wants. The consumer wants a good job done, but is less concerned about the price than he/she might be otherwise.

Toward More Efficient Markets

Governments often encourage the spread of information in inefficient markets. Examples include the requirement that gas stations post their pump prices so that motorists may comparison shop as they drive by, and financial institutions' requirement to advertise interest rates on a common basis (annual percentage yield) to facilitate comparison shopping. In the recommendation section we suggest a variety of strategies which we believe will help create an efficient market for ETP subcontractors and consultants.

Market characteristics that promote the availability of information to consumers include:

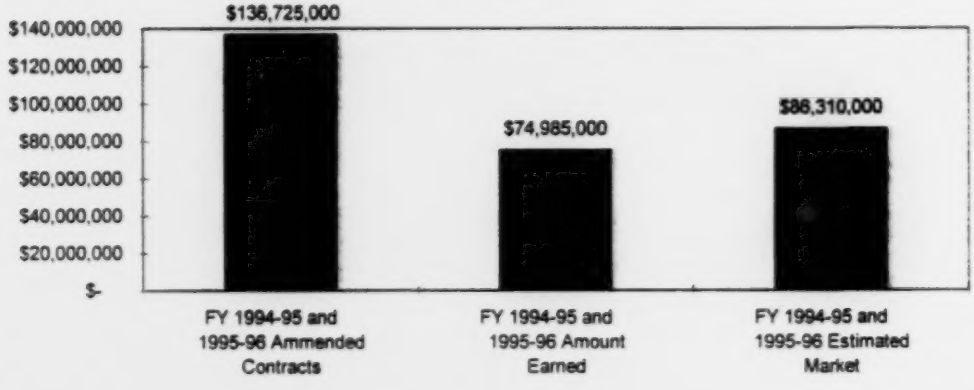
- obvious benefits to the customer from obtaining comparison price information,
- low-cost, centralized information sources,

- easily-identified sellers of the product or service, and
- frequent repeat purchases by consumers.

Size of the Subcontractor and Consultant Market

The first task in estimating the size of ETP's contribution to the subcontractor and consultant market was to estimate the impact of ETP's expenditures on the employee training market in California. Initially, it would seem that the expansion of the training market due to the existence of ETP would be best estimated by the value of its training contracts. The 394 ETP contracts that were completed during fiscal 1994-95 and 1995-96 originally totaled $145,140,000 but were amended down to $136,725,000 during the training process. However, the contractors only earned $74,985,000 under these 394 contracts because a number of the projected trainees did not complete training (which requires placement and employment retention for at least 90 days in a training-related position). ETP's impact on the training market in California probably lies somewhere between that total contracted amount and the actual earnings of the ETP contractors. Our best estimate, which is derived and fully discussed in Appendix A, is that the existence of ETP added an additional $86,310,000 to employee training efforts in California.

ETP Training Market FY 1994-95 and 1995-96



Estimating the size of the subcontractor and consultant market is a complex task. We made two estimates of the size of the subcontractor and consultant market for fiscal years 1995 and 1996. A maximum estimate indicating the largest likely size of the subcontractor and consultant market, and a minimum estimate. In estimating the market, we considered the amount of training for which ETP contracted, reduced it to the amount ETP actually paid for, and estimated additional employer expenditures that would not have occurred without ETP funding. We estimated the size of the consultant market by taking the amount of funding for training and administrative subcontractors in ETP records, estimated the frequency of consultants without an official subcontract, and adjusted these dollar amounts for disencumbrance rates. A complete report on our calculations is included in Appendix A. Table 1 reports our key findings.

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Table 1
Estimated Market for ETP Training and Estimated Market Shares for Subcontractors and Consultants
(Fiscal Years 1994-95, 1995-96)

	Maximum Estimate		Minimum Estimate	
Market Segment	**Dollar Value**	**% of Market**	**Dollar Value**	**% of Market**
Estimated Total ETP Training Market	86,310,000	100.0	86,310,000	100.0
Estimated Administrative Subcontractors	2,635,000	3.0	3,024,000	3.5
Estimated Training Subcontractors	28,110,000	32.6	24,447,000	28.3
Estimated Administrative Consultants	513,000	.6	589,000	.7
Estimated Training Consultants	3,617,000	4.2	3,146,000	3.6
Total Estimated Subcontractor and Consultant Market	**34,875,000**	**40.4**	**31,206,000**	**36.1**

As the table indicates, we estimate that over the last two fiscal years the total market for ETP subcontractors and consultants was between about $35 million and $31 million, or between 40% and 36% of all money spent on ETP training. Subcontractors make up the bulk of the market at 88%, while the much discussed consultants accounted for 12% of the market.

Training subcontractors and consultants are the largest part of this market by far, accounting for around 34% of the total ETP market. Administrative subcontractors' and consultants' market share is slightly below 4% by our estimates, which seems surprisingly small given that ETP budgets 15% for administrative costs.

It is important to note that these estimates include all 394 contracts let by ETP during fiscal years 1994-95 and 1995-96. The remainder of the analysis in this report excludes contracts with consortia and training agency trainers (like community colleges and other training providers), as well as contracts that were subsequently terminated.

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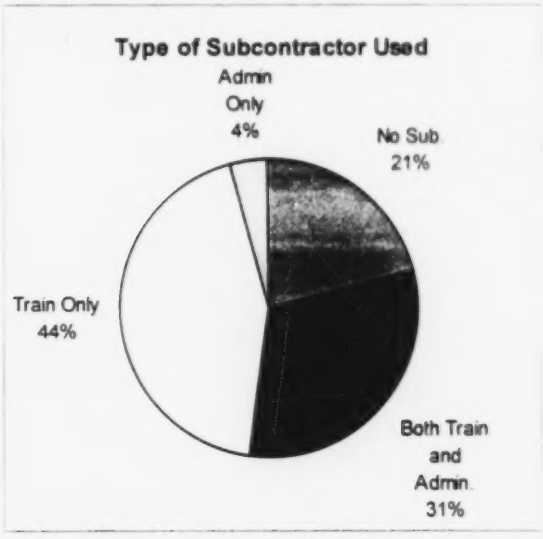
Differences Between Projects With and Without Subcontractors

To analyze the differences between projects that did and did not use subcontractors we took the 260 projects from fiscal years 1994-95 and 1995-96 which were not consortia or training agency projects or subsequently terminated and divided them into four groups:

- contracts with both training and administrative subcontractors,
- contracts with only training subcontractors,
- contracts with only administrative subcontractors,
- contracts with no subcontractors.

As the graph indicates during this period 79% of the contracts reported a subcontractor.



Fewer than one-third of the contracts used both a training and administrative subcontractor, while 44% used a training subcontractor only and four percent used only an administrative subcontractor.

Using data from ETP contract files we compared these groups on a variety of characteristics. Table 2 summarizes this comparison. Most of the data definitions in Table 2 are obvious from the data labels but the following few are not. Under "Size of Business" a small business is defined as one with 1 to 100 employees, a medium-sized business has 101 to 250 employees, and a large business has more than 250 employees. The designated "Office" is the office in which the contract was developed; all contracts are monitored and audited out of the Sacramento and Los Angeles offices. Table 2 identifies three types of "Skills Training". Basic Skills includes vocational English as-a-second-language (VESL) and basic mathematics. Soft Skills include total quality management (TQM); just in time (JIT) delivery; teamwork, leadership, and communication (TLC) training; sales techniques, and customer Service. Hard Skills include a long list of specific job skills such as asbestos removal, auto repair, airplane mechanic, electrician, carpentry, licensed vocational nurse, meat cutting, and welding among others.

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Table 2
Characteristics of FY 1995 and FY 1996
Non-consortia/Training Agency Contracts By Subcontracting Group

	All Contracts	Contracts with Both Training & Administrative Subcontractors	Contracts with Only Training Subcontractors	Contracts with Only Administrative Subcontractors	Contracts without Subcontractors
Count	260	80	114	11	55
Final Contract Amount	$ 285,265	$ 293,627	$ 210,306	$ 591,127	$368,819
Original Contract Amount	$ 312,295	$ 314,585	$ 236,586	$ 597,922	$410,550
Final/Original Contract Amount	91.3%	93.3%	88.9%	98.9%	89.8%
Amount Earned	$ 168,742	$ 178,324	$ 126,562	$ 272,070	$222,546
Amount Disencumbered	$ 116,523	$ 115,303	$ 83,744	$ 319,056	$146,273
Percentage Disencumbered	40.8%	39.3%	39.8%	54.0%	39.7%
Size of Business					
Small	25.9%	18.7%	36.8%	0.0%	20.0%
Medium	18.5%	22.5%	21.1%	0.0%	10.9%
Large	55.6%	58.8%	42.1%	100.0%	69.1%
Type of Business					
Manufacturing	63.3%	73.8%	64.0%	18.2%	54.5%
Services	30.5%	18.8%	29.8%	63.6%	41.8%
Other	6.2%	7.4%	6.2%	18.2%	3.7%
Original Contracted Placement	188	189	149	360	236
Final Contracted Placement	186	184	143	358	242
Number Placed	110	108	87	165	150
Training Subcontract Amount		$ 140,386	$ 111,395		
Training Subcontract Percentage		47.8%	53.0%		
Administrative Subcontract Amount		$ 27,979		$ 61,453	
Administrative Subcontract Percentage		9.5%		10.4%	
Los Angeles Office	50.8%	57.5%	48.2%	45.5%	47.3%
Sacramento Office	25.4%	16.3%	26.3%	27.3%	36.4%
San Mateo Office	23.1%	26.3%	24.6%	27.3%	14.6%
San Diego Office	0.1%	0.0%	0.9%	0.0%	1.8%
Soft Skills Training	89.2%	92.5%	92.1%	100.0%	75.9%
Basic Skills Training	25.5%	41.3%	21.1%	0.0%	16.7%
Hard Skills Training	73.4%	67.5%	71.9%	81.8%	83.3%
Fixed Fee Contract	91.9%	93.8%	92.1%	81.8%	90.7%
Prior ETP Contracts	12.0%	8.8%	9.6%	18.2%	20.4%
Number of Amendments	1.21	1.34	1.18	0.64	1.24

There were both expected and interesting variations in the characteristics of the contracts among the various groups. The group that deviated from the averages in the most interesting ways was the contracts with only administrative subcontractors. Particular areas of interest were in the size of the contract, the disencumbrance rate, the size and industry of the firms involved, and the type of training.

The average size of a contract during the study period was about $300,000, with the original contract starting a little bit higher and the amended contract ending up a bit lower. Contracts with both training and administrative subcontractors followed the same pattern, and lost just a few thousand less in the amendment process. Contracts with only training subcontractors were about $75,000 smaller than average, and were concentrated among small and medium-sized businesses. In contrast, contracts with only administrative subcontractors were twice the average size -- approaching $600,000 -- and included only large employers. As one might expect, the contracts without subcontractors were about $85,000 larger than the average contract and were more concentrated among the large firms, which are more likely to have in-house training departments. This group was also twice as likely to have had a previous ETP training contract.

The disencumbrance rate averaged about 40% for all groups except the one with only administrative subcontractors, which experienced a significantly larger 54% disencumbrance rate. It should be noted that 3 of the 11 contractors in this group had a 100% disencumbrance rate and another had a 91% rate. The remaining 7 contractors had disencumbrance rates below 30%. This analysis of the individual contracts in this group suggests that any disencumbrance rate problem with this group is a problem of performance on selected contracts rather than a problem with the average contract in the group.

The type of business served also varied by contract group. Given the average distribution of about 63% manufacturing, 30% services and 6% other, the group with both types of subcontractors served about 10 percentage points more manufacturers and 10 percentage points fewer service businesses than average, while the group with no subcontractors did the opposite. Again, the stand-out case was the administrative consultant only group which had about 63% of its contracts with service businesses rather than manufacturers.

Less variation was observed in the type of training by contract group. However, administrative subcontractor only group had no basic skills training (present in about 25% of all contracts) and soft skills training in all of their contracts. This group also had more prevalence of hard skills training than average. The main type of hard skills training in this group were office skills training (6 contracts) and production training (5 contracts).

Descriptive statistics of the sort presented in Table 2 may not reveal underlying relationships among all variables. To determine whether there were any underlying relationships that were not revealed in Table 2, we applied a logistical regression model to the data. The logistical model is especially suited for analysis of a choice between two alternatives. In this case, the choice is whether or not to subcontract with a training specialist or a contract administrator. We ran three logistical regressions with three different dependent (choice) variables -- one with subcontracting in general (training

and/or administration) as the dependent variable, one with subcontracting training, and one with subcontracting administration.

The results of the logistical regressions were not particularly surprising since they basically confirmed what was already obvious from the descriptive statistics. A larger contract increased the probability of it having an administrative subcontractor and slightly decreased the probability of it having a training subcontractor. Having a basic skills component increased the likelihood of the contract having an administrative subcontractor relative to just a training subcontractor or no subcontractor. One interesting result was that, relative to the Sacramento office, being administered out of the San Mateo or Los Angeles offices increased the probability of the contract having a subcontractor, particularly an administrative subcontractor.

Overall, the regression analyses revealed that there was a high degree of variation with the identified subcontract and non-subcontract groups. This was manifest in the relatively low statistical significance indicators on the various regression coefficients. The results listed above were statistically significant at the 95% level, a few more were significant at the 90% level (which is rarely reported). None of the regression results were significant at the 99% level of confidence.

Overview of Subcontractor Characteristics

As we noted earlier, over the past three years, there have been approximately 300 subcontractors and consultants involved in ETP contracts. Most have done only a limited amount of ETP work. In this section, we use the results of our survey of 34 subcontractors who were the primary subcontractors on an ETP project in the last year to provide a snap-shot of the subcontractor population.

A Subcontractor and Consultant Typology

While there is wide variety in the characteristics of people and companies who do ETP subcontracting and consulting, our survey data provides a profile of the typical primary ETP subcontractor. The typical primary subcontractor was in the training field before he or she began doing ETP subcontracting. They heard about ETP and started designing and delivering projects for their clients, and have been involved with ETP for 6.6 years. The typical subcontracting company is mid-sized with 6 to 20 professional employees, and provides a full range of ETP services: proposal development, administrative services, and training. ETP contracts make up about 40% of these companies' revenue.

Reviewing our data and what we learned about primary subcontractors, we found that we could classify these subcontractors and consultants into seven categories based on the characteristics of the organization and the services they provide. We believe this exercise is useful because understanding how subcontractors and consultants are organized, the services they provide, and the incentives that drive them can help to shape policy. Listed below are the categories we found and our estimate of the proportion of the subcontractor and consultant population that falls into each category.

- *Full Service Companies (20%):* These companies range in size from 6 professional employees to nationally known management consulting firms with hundreds of professional employees. They provide a full range of ETP services including proposal development, administration, and a range of training programs. These firms can usually provide a complete training needs assessment and may own proprietary training packages which they customize for individual companies. They occasionally subcontract for specialized trainers or other services.

- *Public or Non-profit Agencies (5%):* This category includes a wide range of public and private non-profit agencies. They range from small community based agencies, to unions, to large universities and community colleges. Some provide training only, others offer full service. We found their non-profit mission makes them a distinct group.

- *Hollow Companies (25%):* These companies market a full range of ETP services but are in fact small companies that subcontract out for most of the services they provide to a network of other small firms or individuals. Typically these companies do not employ full-time trainers and may have only one or two professional employees. Their primary expertise appears to be in developing proposals and administering projects. Most or all training is typically subcontracted out.

- *Niche Trainers (20%):* These companies are small highly specialized training companies, usually with few employees. They provide specialized training in narrow market niches. They may, for example, offer TQM training for medium-sized manufacturers or only provide vocational ESL. They may occasionally offer proposal development or administrative services for ETP contracts, in order to help a client afford a training package, but their basic business remains training.

- *Free-lance Project Administrators (20%):* This group is made up of individuals and occasionally partnerships, who primarily provide administrative services, often one project at time. They may occasionally help develop a proposal, but their assistance is primarily to get a proposal into ETP approved format rather than to design training.

- *Free-lance Packager (10%):* This group is made up of individuals and occasionally partnerships whose primary business is seeking out companies who may be interested in ETP training, and helping them develop a proposal that will be accepted by the Panel. These companies generally do little systematic needs assessment. They may act as brokers for other companies that provide training or administrative services.

- *Project Doctor (<1%):* Much like Hollywood script doctors, these subcontractors and consultants often become involved in a project after it has run into trouble. They tend to specialize in solving administrative problems and negotiating with ETP. This appears to be a very small group of subcontractors and consultants.

It is important to note that individuals and companies may perform these different roles at different times as companies evolve over time. A free-lance packager may grow into a

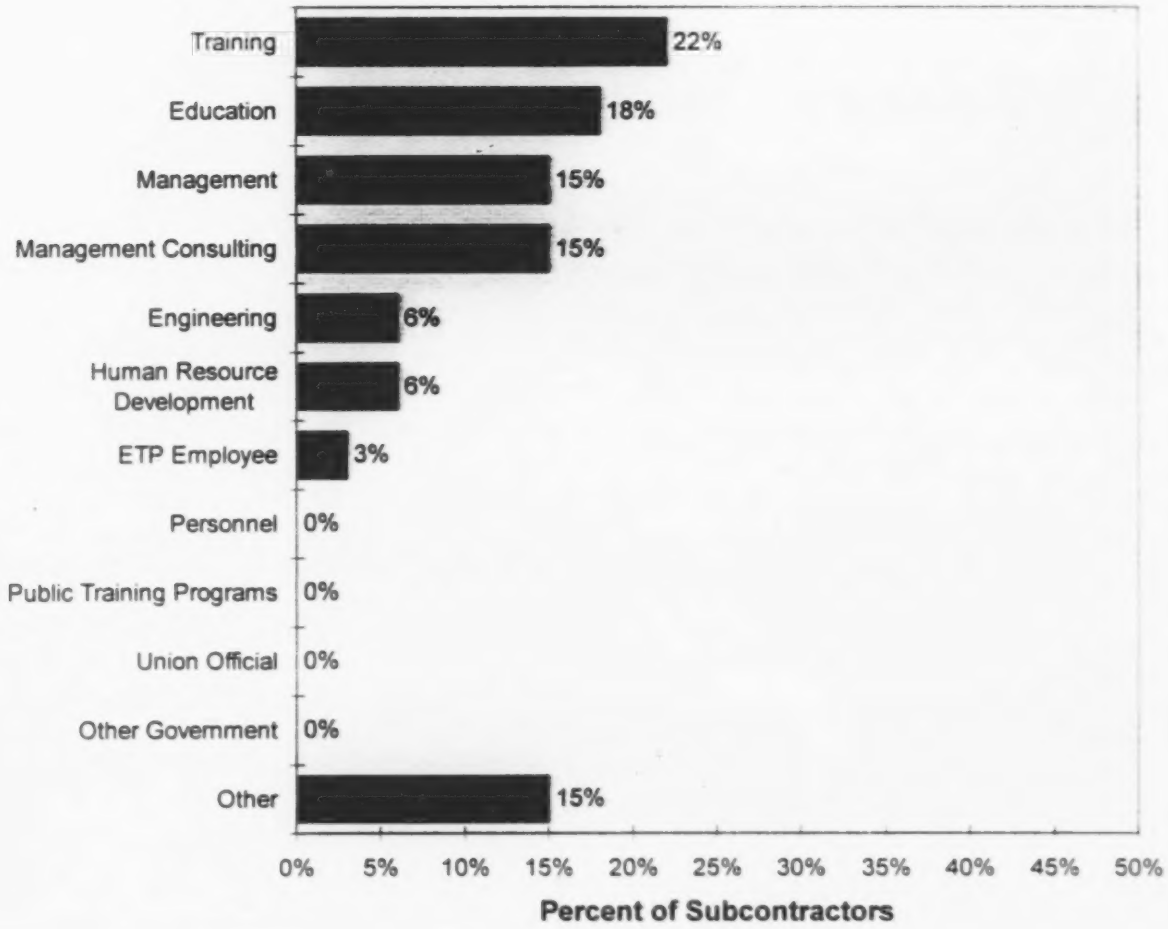
hollow company as the subcontractor or consultant becomes more experienced and builds a network of other companies. A niche trainer may become a full service company if it builds expertise in ETP and finds it profitable to provide a wider range of services.

Details of Subcontractor Characteristics

With this overview of subcontractors and consultants and how they operate, we now turn our attention to a more detailed examination of the subcontractors characteristics, as revealed in our project sample.

Before individual subcontractors became involved with ETP, they were most likely to be working in the fields of training, education, management or management consulting. A complete breakdown of their previous fields is provided below.

Subcontractor Background Before Working With ETP



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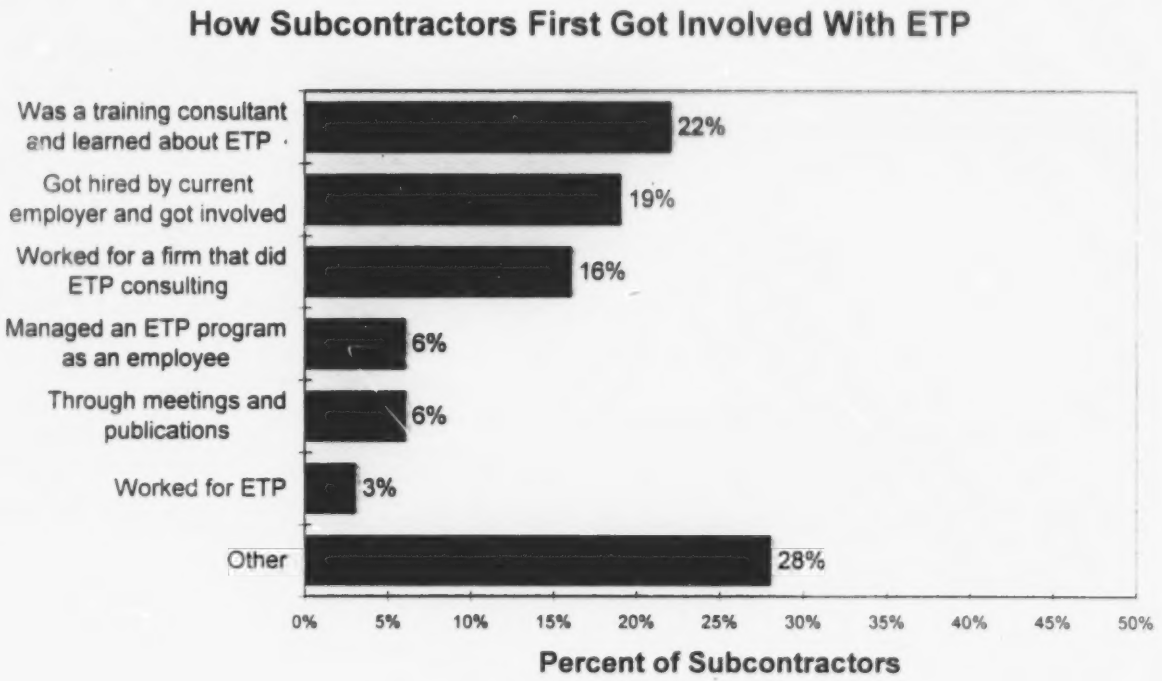
The survey information indicated that subcontractors became involved with ETP through a wide variety of experiences. The largest group included those already working as training subcontractors and consultants when they learned about ETP and started using it. Others were hired by a company that was already doing ETP work, and others were working for a company that did ETP work, and then decided to strike out on their own. The chart below shows the various routes subcontractors in our sample took into ETP work. Subcontractor's experience with ETP ranged from 2-13 years with 6.6 years experience on average.



Another key characteristic of subcontractors is how dependent they are on ETP funds. We asked each subcontractor or company what portion of their revenue they received from ETP projects in the last year. The responses ranged from less than 1% to 100%. On average, the subcontractors reported that 40% of their revenue came from ETP. To analyze the data further, we broke the population into four groups based on the percent of revenue they received from ETP work. This seems important to us, because those contractors most dependent on ETP for revenue will be those most likely to be involved in attempting to shape ETP policy and those bringing the largest number of projects to the

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Panel. As the table on the following page shows, we classified about 20% of the subcontractors as "ETP Dependent," meaning that they got over 75% of their revenue from ETP projects; a second group of the same size was deemed "ETP Dominated," because they got over half their revenue from ETP. About 60% got less than half their revenue from ETP.

Table 3
ETP Funds as A Percent of Total Revenue

Group (Percent of Revenue from ETP)	**Percent of Surveyed Subcontractors**
ETP Dependent (75% or more of revenue from ETP)	21%
ETP Dominated (50% to 74% of revenue from ETP)	21%
ETP Active (20% to 49% of revenue from ETP)	29%
ETP Independent (<20% of revenue from ETP)	29%

When asked what other types of work the subcontractors did besides ETP funded projects, the most common responses were non-ETP funded training (73%) and management consulting (72%).

How do employers choose subcontractors?

It appears, from our survey data, that subcontractors tend to reach employers before they have heard about ETP. Forty-two percent of the employers surveyed said that they learned about ETP from their subcontractor.

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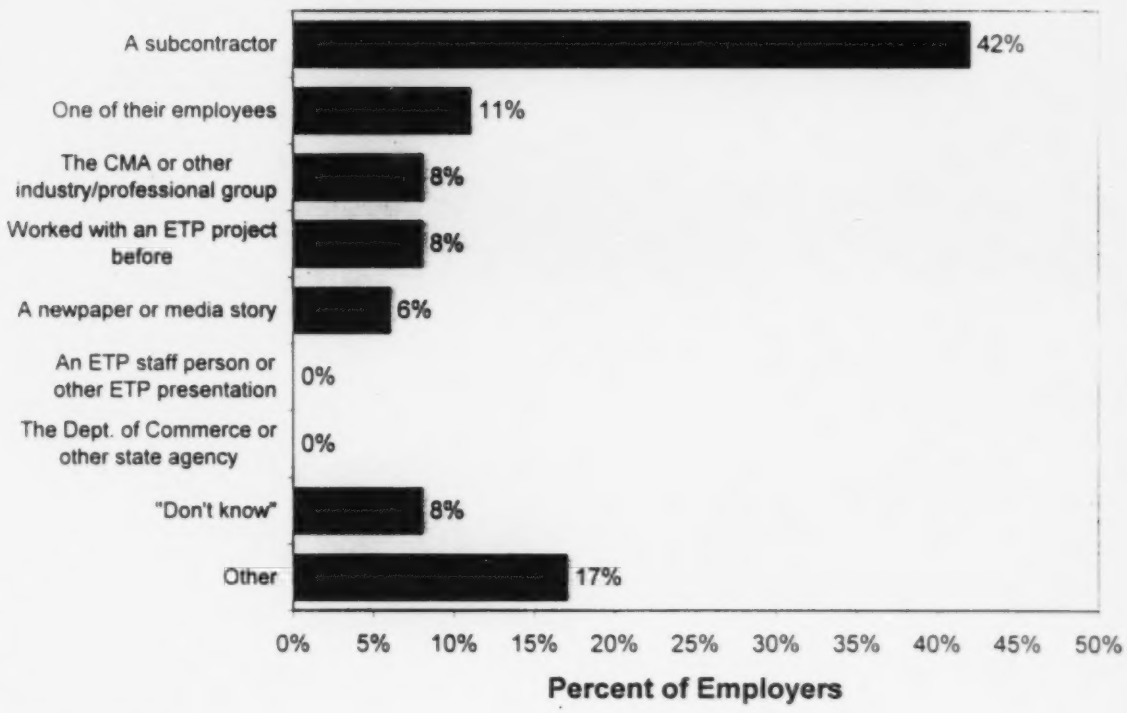
How Employers First Heard About ETP Training



Only half of the employers reported that they considered more than one subcontractor before hiring them. The employers that did "shop" for a subcontractor considered on average 2.8 subcontractors, indicating that most that did shop talked to two or three subcontractors.

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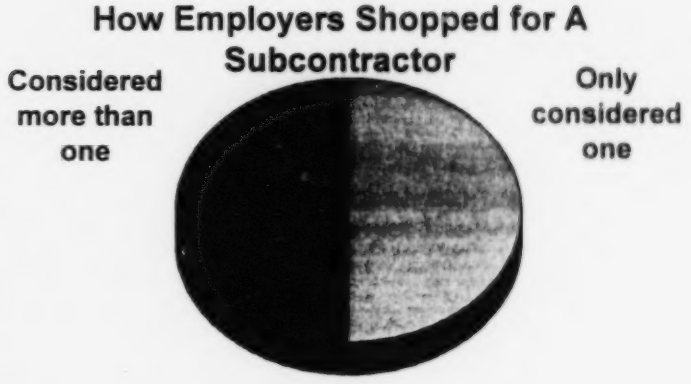
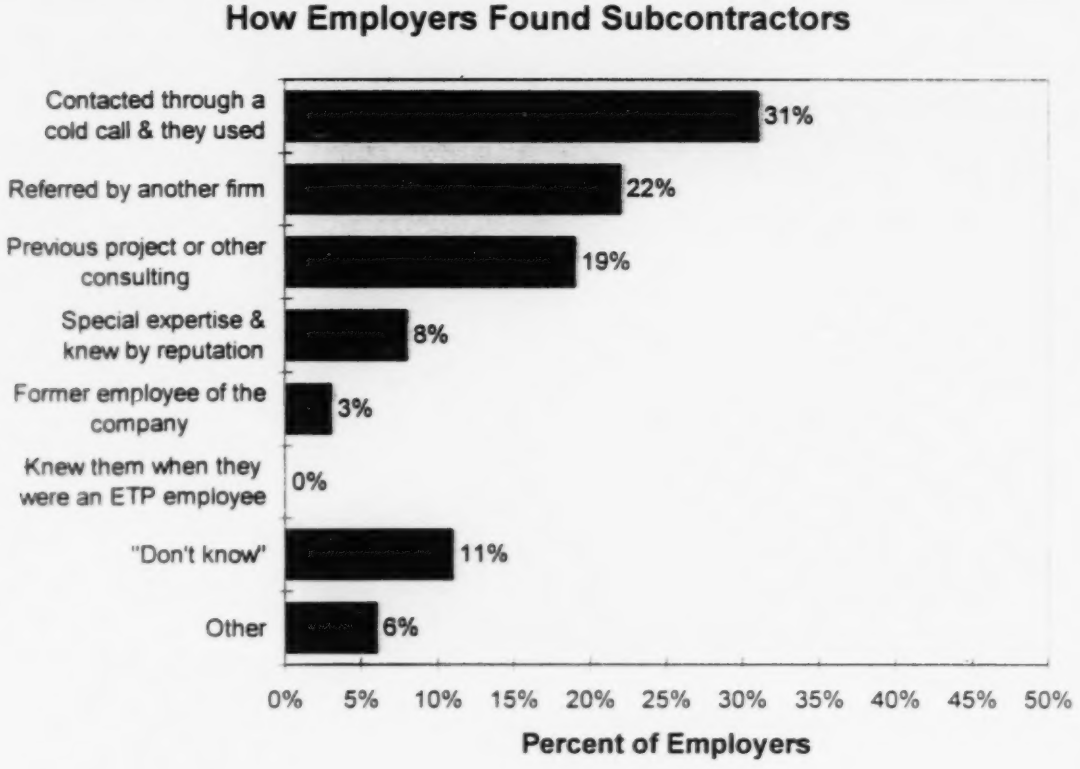


The largest group of employers reported that they found their subcontractor through a cold call from the subcontractor (31%). Twenty-two percent were referred to the subcontractor by another firm and 19% had used the subcontractor before. A complete breakdown of how employers found subcontractors is below.



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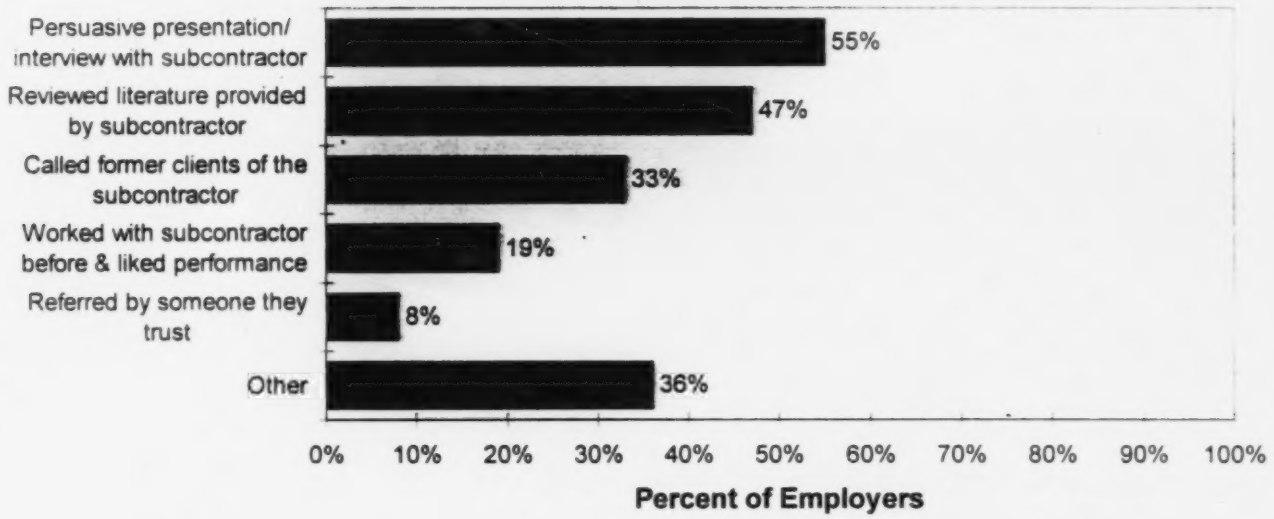
When asked how they evaluated the subcontractor, slightly over half the employers said they based their evaluation on an interview with the subcontractor, slightly less than half reviewed the consultant's literature. Surprisingly, only one-third called a previous client.

How Employers Evaluated Subcontractors Before They Chose



In several interviews and focus groups, subcontractors suggested that ETP staff tried to discourage employers from using subcontractors. When we asked employers what advice they got from ETP staff about using subcontractors, 44% reported they got no advice and 36% said the staff were neutral about using subcontractors. Only 13% reported the staff "said or implied" subcontractors were unnecessary, and 7% said the staff recommended using a subcontractor.

How do subcontractors market their services?

We also asked subcontractors how they generally got their clients. Overall, subcontractors reported that 20% of their clients came from referrals from non-ETP clients, and an additional 18% were referred by ETP clients. Fifteen percent of clients were existing clients for who the subcontractor had provided non-ETP services. Surprisingly, subcontractors reported that only 19% of clients came from cold calling or mailing and 6% from other business networking.

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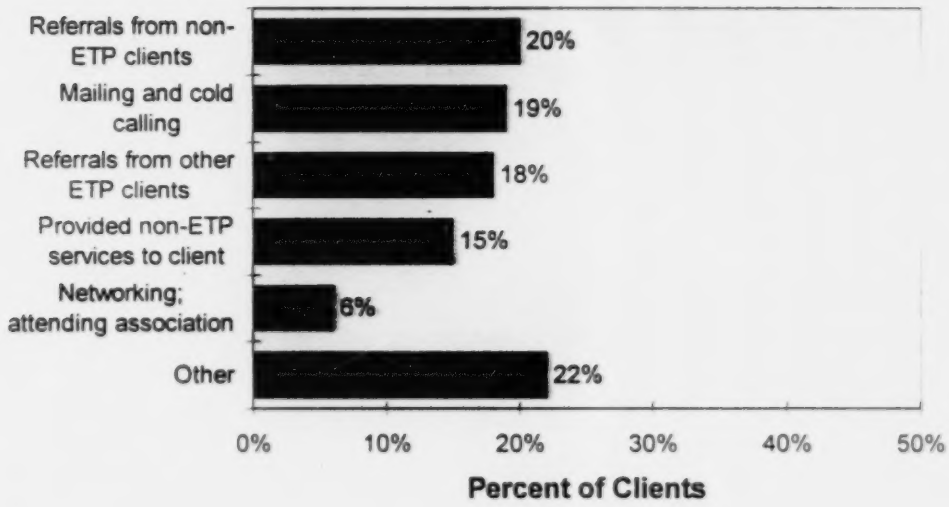
How Subcontractors Generally Obtain Their Clients



To gain some additional insight into marketing, we asked subcontractors how they got the particular employer sampled in our survey as a client. The majority (58%) said they found them through "other business networking," about 20% had done other non-ETP funded consulting for the company and slightly over 10% said they obtained the client through cold calling.

What services do subcontractors provide?

We broke the ETP process down into its component parts and asked employers to tell us what tasks they primarily performed, what tasks the subcontractor primarily performed and which tasks were shared[8]. The following table shows how the work was divided for the projects in our sample, according to the employer.

While there was wide variation in how work was divided in each project, our data allows us to draw a typical profile of the tasks done by employers and the tasks done by subcontractors. Overall, employers were primarily responsible for management tasks that directly involved the employees to be trained, financial tasks and providing facilities. Subcontractors were primarily responsible for dealing with the details of ETP compliance and delivering classroom training.

[8] Tasks were considered primarily performed by one party if they did two-thirds or more of the work. If neither part performed two-thirds of the work the task was considered shared.

Employers reported they typically were principally responsible for the following tasks:

- training needs assessment,
- initiate first contact with ETP staff,
- develop budget,
- appear in front of Panel,
- design training,
- recruit/identify participants,
- intake participants,
- provide classroom/lab facilities.
- deliver SOST,
- monitor SOST,
- verify complete hours,
- verify post-training retention,
- supply information and meet with monitors,
- invoice for completed participants,
- follow-up for payment.

Consultants typically were principally responsible for the following tasks:

- write project narrative,
- negotiate with ETP staff,
- draft, revise and submit final proposal,
- select and customize training materials,
- deliver classroom/lab training.

Table 4
How Work On ETP Projects Is Divided According To Employers

Task	Employer	Subcontractor	Shared
Training needs assessment	**58%**	17%	25%
Write project narrative	28%	**50%**	22%
Initiate first contact with ETP staff	**49%**	43%	8%
Develop budget	**40%**	23%	37%
Negotiate with ETP staff	34%	**43%**	23%
Draft, revise and submit final proposal	25%	**58%**	17%
Appear in front of Panel	**41%**	28%	31%
Design training	**42%**	33%	25%
Select and customize training materials	37%	**40%**	23%
Recruit/Identify participants	**80%**	6%	**14%**
Intake of participants	**53%**	24%	23%
Provide classroom and lab facilities and equipment	**92%**	6%	2%
Deliver classroom/lab training	25%	**50%**	25%
Deliver SOST	**52%**	37%	11%
Monitor SOST	**46%**	23%	31%
Verify completed hours	**50%**	31%	19%
Verify post-training retention	**69%**	20%	11%
Supply information and meet with monitors during project	**51%**	14%	**35%**
Invoice for completed participants	**41%**	**41%**	18%
Follow up for payment	**47%**	39%	14%

We asked subcontractors the same questions about the same set of projects. Not surprisingly the subcontractors reported they played a much larger role then the employers reported. According to the subcontractors, employers were typically principally responsible for the following tasks:

- appear in front of Panel,
- recruit/identify participants,
- intake of participants,
- provide classroom/lab facilities and equipment,
- deliver SOST,
- monitor SOST,
- verify post-training retention, invoice for completed participants[9],
- follow up for payment.

[9] An equal number of subcontractor reported that this task was principally done by the subcontractor and employer.

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According to subcontractors, they were typically responsible for the following tasks:

- training needs assessment[10],
- write project narrative,
- initiate first contact with ETP staff,
- develop budget,
- negotiate with ETP staff,
- draft revise and submit final proposal,
- design training,
- select and customize training material,
- deliver classroom/lab training,
- verify completed hours,
- invoice for completed participants.

Unlike employers, subcontractors reported that some tasks were typically shared:

- training needs assessment,
- verify post training retention.

Complete data on the subcontractor's responses are presented in the following table.

[10] An equal number of subcontractors reported that this task was principally done by the subcontractor and principally shared.

Table 5
How Work On ETP Projects Is Divided According To Subcontractors

Task	Employer	Subcontractor	Shared
Training needs assessment	12%	**44%**	**44%**
Write project narrative	19%	**62%**	19%
Initiate first contact with ETP staff	28%	**63%**	9%
Develop budget	19%	**43%**	38%
Negotiate with ETP staff	38%	**40%**	22%
Draft, revise and submit final proposal	19%	**47%**	34%
Appear in front of Panel	**50%**	10%	40%
Design training	13%	**50%**	37%
Select and customize training materials	16%	**59%**	25%
Recruit/Identify participants	**69%**	9%	**22%**
Intake of participants	**44%**	41%	15%
Provide classroom and lab facilities and equipment	**75%**	**16%**	**9%**
Deliver classroom/lab training	15%	**70%**	15%
Deliver SOST	**46%**	38%	16%
Monitor SOST	**42%**	39%	19%
Verify completed hours	31%	**50%**	19%
Verify post-training retention	**35%**	31%	34%
Supply information and meet with monitors during project	**36%**	30%	**34%**
Invoice for completed participants	**41%**	**41%**	18%
Follow up for payment	**48%**	39%	13%

In addition to asking about the tasks they performed, we asked subcontractors if they subcontracted any training or administrative work. Only 13% of the subcontractors reported they had subcontracted work on the projects we sampled. In all cases, the subcontracting was for training and not for administrative work. The average amount of training subcontracted was high, 70%. In several cases, 100% of the training was subcontracted.

We also wanted to know if the subcontractors or the employer had the most direct contact with ETP. Fifty-four percent of the subcontractors reported that, on the projects studied, the employer had the most direct contract with ETP. We asked the 46% of the subcontractors who had most of the direct contact with ETP why they had most of the contact. The most common response was that the employers were simply too busy to deal with ETP, or that the employer considered it the subcontractor's job to deal with ETP.

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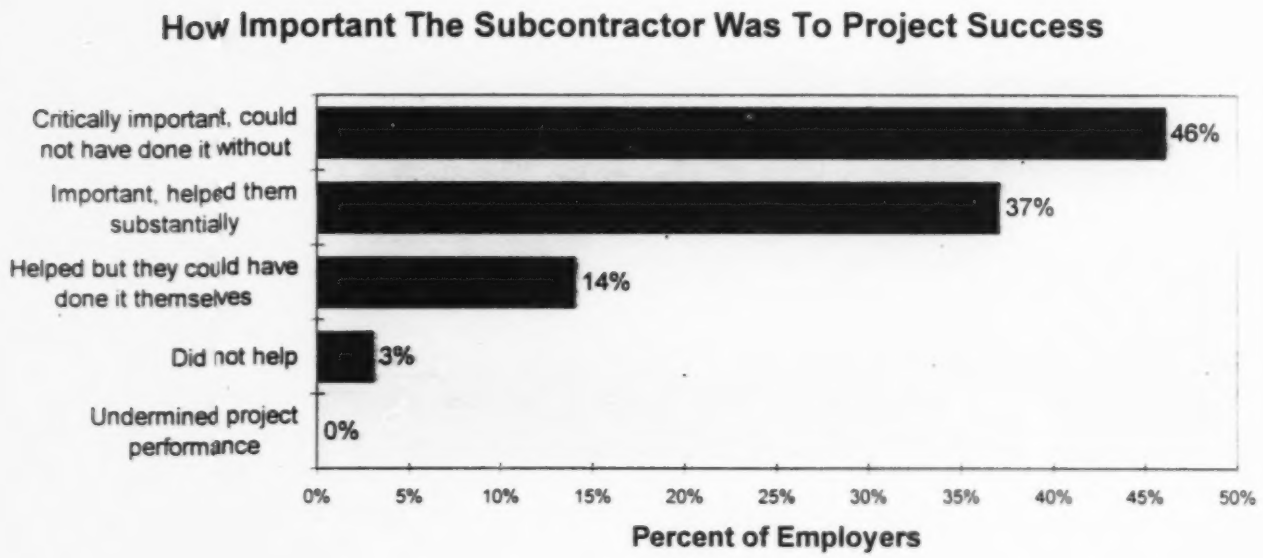
How satisfied are employers with the subcontractors they chose?

Overall, most employers surveyed believed the subcontractors they hired played a key role in the success of their project. As the graph below indicates, over 80% of these employers said subcontractors were either "critically important" or "important" to the success of their project. Only 3% responded that the subcontractors did not help at all.



To further test employer's satisfaction with the subcontractor they hired, we asked them if they would use the same subcontractor again, use a different subcontractor, or do the next ETP project on their own. Over two-thirds said they would use the same subcontractor again. We would classify these employers as "satisfied." Twenty percent said they would do the project on their own. It is unclear whether these employers are satisfied or not. Finally, 11% said they would choose a different subcontractor if they did another ETP project. We would classify these employers as "dissatisfied."

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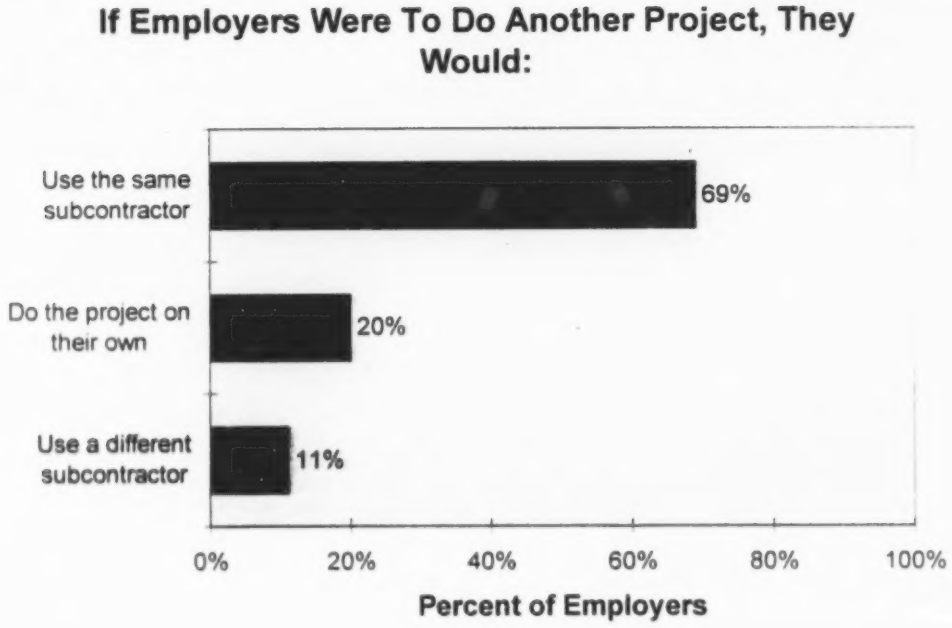

These data persuade us that most employers remain satisfied with the subcontractors they choose. There does seem to be a problem group of subcontractors however. We estimate from this survey that between 10% and 20% of the subcontractors on the projects we studied did not perform up to the expectations of the employer. The reasons why this group of subcontractors did not meet the employer's standards is unclear. We don't know the degree to which the dissatisfaction is caused by miscommunication, a lack of competence on the part of the subcontractor, or other problems.

Interestingly, when we cross-tabulated this evaluation of the subcontractor with whether or not the employer considered more than one subcontractor, we found that all the employers who were dissatisfied had not shopped for a subcontractor, but considered only one. Similarly, 31% of the employers who did not shop for a subcontractor said they would rather do the next project on their own compared to only 12% of those employers who did shop. All this indicates to us that a lack of information about alternatives does lead to less satisfaction with the choice of subcontractor.

We attempted to answer this question by first asking the employers to identify all the benefits they got from using a subcontractor (see following table) and then to identify the "most significant" benefit. Clearly the most important benefit was in helping manage what the employers saw as the complex ETP process. Fifty-one percent of the employers gave a benefit related to managing the program as the most significant benefit received from using a subcontractor, while only 30% reported a benefit related to training. Fully one-quarter of the employers reported that help keeping track of complex ETP "rule and policy changes" was the most significant benefit. An additional 17% said "handling ETP paper work the employer's staff could not," and 11% believed a subcontractor "made it easier to get ETP

to approve the project." Conversely, 19% said "provide trainers employer did not have in-house" and 11% reported "designed custom training" as the most significant benefit.

Table 6
Benefits That Companies Get From Using A Subcontractor

Benefits	Percent Response	Most Beneficial
Needed a subcontractor to keep track of all the complex rule and policy changes in the ETP program.	67%	25%
Did not have enough in-house trainers.	61%	19%
Needed subcontractors to design custom training.	61%	11%
Believed it would be easier to get ETP to approve the project with a subcontractor.	61%	11%
They handled ETP paperwork our staff could not.	58%	17%
Did not have staff capable of managing program.	44%	6%
Cost less to use a subcontractor than to use staff.	33%	0%
Made it easier to get top management's approval.	31%	0%
Believed our company could get more money per participant with a subcontractor.	25%	0%
Shared the risk of people not completing.	14%	0%
Other	25%	11%

Next we asked employers if the agreements they made with subcontractors about what tasks they would perform held up through the project. Over 80% of the employers reported that they had a clear agreement at the beginning of the project that held up throughout; fewer than 20% reported making significant changes in the agreement during the training. About 20% of the employers reported that their staff ended up doing work that the employers intended the subcontractor to do. In almost 90% of these cases, the employer, rather than ETP, paid for the additional work.

How are subcontractors compensated?

We found a wide range of compensation arrangements within the projects studied. For administrative subcontractors the most common arrangement is a fixed fee for the entire project. Surprisingly, few administrative subcontractors shared risk with the employer by receiving a fee just for successful completers.

We asked the employers if the fixed fee was adequate to cover the direct costs of training. Direct costs were defined as cost of training exclusive of the salaries of trainees. Sixty-one

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percent reported that the fee was adequate. We then asked the 39% that said the fixed fee for training was inadequate what percent of costs the fee covered. On average, employers estimated the fee covered 72% of their direct training costs. Estimates ranged from 50% to 90%.

Eleven percent of the employers reported that they ended up paying their administrative subcontractor more than the 15% administrative fee. While 19% of the employers reported paying the training subcontractor more than the fixed fee per trainee. We asked employers who said they paid additional money to their subcontractors why they did. The most common response given by 75% was that they had to pay money beyond the ETP fee to get the quality of training they wanted. Half said that the cost of training absorbed the 15% administrative fee, so administrative costs were paid out of company funds, and half said that the 15% administrative fee was used to pay the subcontractor for developing the proposal. One quarter reported that ETP funds paid the training subcontractor while the company paid in-house trainers.

Subcontractors' and Consultants' Role in ETP

Much of the controversy that swirls around ETP subcontractors and consultants deals with different group's assessment of the role they play and the impact of that role. To some, subcontractors and consultants are opportunists looking for windfall profits who threaten ETP's future. To others, subcontractors and consultants are white knights here to help make ETP work. Most observers see subcontractors and consultants as offering both threats and benefits to ETP. In this section, we review what we learned about different constituencies' views of subcontractors and consultants and then offer our own assessment.

Staff views of subcontractors and consultants:

Many ETP managers and staff who were interviewed have a skeptical view of subcontractors and consultants. We believe such views are often shaped largely by the relatively few problem projects that come to the staff's attention and take up a lot of their time, and which involve a subcontractor or consultant. This can be particularly true for managerial staff. They only see problem projects, not routine projects where subcontractors and consultants may have made a significant contribution to the project's success. There appears to be a significant variation in the degree to which staff see subcontractors and consultants as a problem. Attitudes appear to vary somewhat from one regional office to another.

Staff voiced several specific concerns regarding the role of subcontractors and consultants. Interviewed field staff are concerned that subcontractors and consultants "get to the employers first and demonize ETP to make the process seem horrendous." Staff argue that subcontractors and consultants do this to convince the employer to hire them. This sets up an adversarial relationship between the employer and ETP. Some staff object that subcontractors and consultants keep them from having direct contact with senior managers, thus frustrating their efforts to make sure employers are aware of various issues. The example often given by staff is that they will call an employer and then get a call back from

the subcontractor or consultant. Field staff also worry that subcontractors and consultants who only work on ETP projects sporadically don't keep current with ETP regulations and practices. As a result, they give employers bad advice and then blame field staff when there is a conflict.

Staff also believe subcontractors and consultants have powerful financial incentives, especially if they are paid a commission when a project is approved - so called "fund and run" subcontractors and consultants, to pump up the size of projects beyond what the employer can reasonably expect to complete. This leads to high levels of disencumbrances which in turn cause a variety of problems for ETP.

Staff charge that some subcontractors and consultants are offering low quality or uncustomized training and are hoodwinking unsophisticated employers into buying it because the money they are spending is the State's. By offering only off-the-shelf curricula and low paid instructors, subcontractors and consultants can make excessive profits.

Finally, some staff simply object to administrative subcontractors and consultants, because they believe they are unnecessary. These staff see the ETP process as simple and believe any employer can get through the process easily, and they simply do not need subcontractors and consultants. Most staff do acknowledge that many firms lack the capacity to provide training in-house and must hire training subcontractors and consultants to actually deliver training.

Despite all these objections to subcontractors and consultants, when pressed, all field staff can mention subcontractors they have worked with who were well- informed and provided employers with valuable service.

Management staff has some additional worries about subcontractors and consultants. Management staff often see subcontractors as constantly testing ETP policy, looking for loopholes and exceptions which allow them to get additional funding for their clients and ultimately for themselves. A related worry is that subcontractors and consultants seek out the largest employers because it is most profitable to serve them, thus skewing the mix of ETP projects towards larger companies.

Quality of training is an additional issue for senior ETP staff. Senior staff is especially worried that the fixed fees have created an incentive for a group of marginal contractors to attempt to turn ETP into a cash cow by persuading employers to buy low quality, uncustomized, often irrelevant training. Getting these projects through the Panel for the existing fixed fee for training results in the reaping of large profits by keeping the cost and quality of training low. If such projects do exist and attract public attention, it will reflect badly on the program.

Managers are also concerned that many subcontractors and consultants have "retreated to the shadows," because they don't want their agreements with employers scrutinized by the Panel. For the most part, managers think subcontractors and consultants are working hard to keep information about their practices and pricing scarce in order to keep the buyer in

the dark. In general, management staff is concerned that employers may not have the information they need to evaluate subcontractors and consultants, since there is little public information on their track record or fees. Management recognizes that many employers learn about ETP through subcontractors and consultants and that senior management in many companies have little direct contact with ETP.

Senior managers believe that subcontractors and consultants attempt to manipulate ETP policy by going directly to the Legislature or the Panel and thus undermine the staff.

A major issue for senior staff is the fear that aggressive marketing of the availability of ETP funds will bring in proposals for training that do not match ETP's priorities. More specifically, managers believe subcontractors and consultants may seek out companies with existing training and simply get them to substitute ETP funding for existing funding, thus not adding at all to the amount of training done.

Panel members' view of subcontractors and consultants:

While Panel members hold a variety of views about subcontractors and consultants, overall, the Panel members we interviewed had a less negative and more balanced view of subcontractors and consultants than did the staff we interviewed. Most Panel members see subcontractors and consultants as legitimate businesses who contribute to ETP's ability to create and execute projects. Panel members also recognize the downside of subcontractors and consultants and are particularly concerned about excessive fees.

Panel members, who are principally involved with setting overall ETP policy, saw subcontractors and consultants as a particularly active group in the policy process. Individual members differed on how influential subcontractors and consultants actually were in the policy process. One member, for example, said subcontractors and consultants were as influential as major constituent groups such as labor unions, and the CMA, while another thought subcontractors and consultants, while very active, exercised little real influence. Several Panel members noted that subcontractors and consultants were quick to go directly to the State Legislature or to hire an attorney when they had a dispute with ETP.

One perspective several Panel members had that was not found among senior staff, and that Panel members recognize, was that employers often need an advocate in the complex ETP process. In the words of one Panel member, "until we make the process less bureaucratic and more user friendly, companies will need subcontractors and consultants."

Several Panel members recognized that problems with subcontractors and consultants often spring from the fact that employers lack information about ETP in general and subcontractors' and consultants' performance and prices. Thus employers may be easily manipulated, especially when they believe they will get "free government money." In general, Panel members were in favor of giving employers more information about subcontractors and consultants and their track records.

Subcontractors view of staff:

There is a wide range of attitudes towards Panel staff among subcontractors. Many subcontractors, particularly those who have done only a few ETP projects, and those who are themselves former ETP staff people, see ETP staff as partners in the process and report good relations. Other subcontractors, particularly a group who are ETP dependent, see their relationship with ETP as adversarial. They view themselves as vigorous advocates for their clients in perpetual conflict with the staff. The subcontractors with the most negative view of ETP staff focus most on the work of monitors. In the words of one subcontractor, they get a "wall of hostility" from monitors. Another said monitors treat their clients "like they are on trial for a crime." Several subcontractors agreed that they try to keep employers away from ETP; they use terms like "serving as a buffer" or "putting up the filter" to describe how they separate their client from ETP. While some subcontractors argued that they did not demonize ETP and attempt to frighten their clients away from working directly with ETP, others admitted they did "tell horror stories" about ETP, but only, they claimed, because they were true.

Interestingly, most subcontractors we interviewed agreed that there is a problem group of subcontractors and consultants, many of whom are poorly informed about ETP, and who may make excessive profits and deliver little of value. They saw the problem as one of ETP staff being too concerned about the process and not caring enough about the quality of training that was actually delivered. In the words of one subcontractor, "ETP shouldn't be concerned with who is making money, but with what clients (employers) are getting for the money."

Most of the subcontractors we interviewed supported the idea of ETP providing additional information about the experience and performance of subcontractors. There was less enthusiasm for revealing price information.

Why Some Consultants Prefer to Remain Hidden

We asked subcontractors in both the focus groups and the phone interviews why some consultants remained hidden and did not make official subcontracts for either administrative or training services. One subcontractor summed up hidden consultants quickly with the phrase "less liability, more flexibility."

To elaborate, one common reason why consultants remained hidden is that they did not want to share the risk of trainees not completing. The consultants believed that once they made a contract with the employer, if they provided the services they should be paid. Hence, if individual trainees failed to complete training, but the classes were offered, the training provider believes they should be paid in full. These trainers are quick to point out that they are not responsible for whether or not trainees complete, since the most common reason for not completing is that trainees are pulled out of training for production.

Several trainers also said that getting paid outside the contract guaranteed they would be paid promptly, if they had an official subcontract they would have to await ETP approval of payment. Other trainers said they charge substantially more than the fixed fee and did not want to sign a contract for a lower fee, even if they got supplemental payments outside the contract.

Administrative consultants said that they remained hidden because development costs are not covered by ETP contracts and not ETP's concern. Interestingly, the subcontractors were not uniformly opposed to ETP's new policy of requiring that fees paid development consultants be revealed in the application. About half the subcontractors interviewed thought the policy would have no impact on them or other subcontractors and consultants. About 40% saw it having a beneficial impact say things such as: "It will help ETP monitor quality better," or "It will help ETP keep track of subcontractors and consultants who cause problems." Those who saw a negative impact, most often reported that it would discourage employers from applying for ETP money because they don't want to see private transactions revealed in public.

Impact of Subcontractors and Consultants on ETP

In this section, we bring together all the information from the interviews, focus groups and surveys to summarize our assessment of the impact of subcontractors and consultants on ETP. Since subcontractors' and consultants' most severe critics will admit some subcontractors and consultants provide some valuable services, and since the most ardent defenders of subcontractors and consultants admit there are problem subcontractors and consultants out there, we have organized our summary around various aspects of the ETP program and attempted to demonstrate how subcontractors and consultants offer a benefit to ETP, and contrast this with the risks that they pose to the program.

Marketing

Benefits: This is the area with the strongest consensus. All the groups we interviewed recognized that subcontractors and consultants play a major role in marketing ETP. One senior manager estimates that they are responsible for bringing in as much as 80% of all ETP projects. Our data show subcontractors and consultants market aggressively to individual companies and reach hundreds of employers that ETP marketing could never reach directly. In general, it appears that subcontractors and consultants respond to the priorities and incentives created by the Panel. For example, when ETP made basic industries a priority, subcontractors and consultants shifted their marketing to those industries or left ETP consulting. To us this illustrates how ETP can use the powerful profit incentives that drive subcontractors and consultants to achieve its policy objectives.

Risks: Subcontractors and consultants are aggressive, they will test the boundaries or push the envelope on ETP policies to try and qualify projects which are marginal, look for loopholes to slip through projects that may conform to the letter of ETP policy but not to the spirit of ETP priorities. A major risk we identified is that subcontractors and consultants may seek out large firms with substantial existing training programs and use

their knowledge of ETP to qualify these ongoing programs for ETP funding. Subcontractors and consultants may prefer this approach since it is less costly for them to simply package or repackage an existing program rather than go through the difficult steps of needs assessment and customizing training. The primary risk to ETP is that projects like this do not add to the stock of training but are simply substitutes for existing private training expenditures.

In order to insure they are employed, subcontractors may demonize ETP and make the process appear more difficult then it actually is, undermining ETP's own marketing efforts.

Finally, subcontractors and consultants will not market to employers who cannot be served profitably, whether they are an ETP priority or not. Such is the case with small employers who subcontractors argue can not be served profitably under a fixed fee contract. Situations like these undermine ETP's ability to achieve its objectives if it relies on subcontractors to bring in projects.

Developing Projects

Benefits: All the groups we interviewed recognized that many of the training and management companies that do ETP subcontracting have a wealth of specialized expertise in skill areas, in industries, and managing projects. Good subcontractors and consultants help companies do effective needs assessment that links training to larger corporate goals, they deliver high quality state-of-the-art training that is customized for the individual companies. They help companies design programs that are appropriate in size and scope and that disrupt productions as little as possible. Subcontractors also bring innovation to ETP in the design of projects and the delivery of training, such as the development of consortia to serve small businesses.

Finally, knowledgeable subcontractors and consultants will sort out projects and keep projects which are ineligible from coming to the staff. Also, by developing proposals which conform to ETP standards, subcontractors and consultants save both staff and employer time.

Risks: Some subcontractors and consultants driven by powerful profit incentives will try to shape projects to be most profitable for them. This may mean creating projects which are larger then they should be, substituting off-the-shelf curriculum for customized training or not conducting a careful needs assessment to insure training will lead to desired company goals. Subcontractors and consultants will sometimes evade or manipulate rules to increase profits. Subcontractors and consultants may not always act in the best long-term interest of an employer, they may, for example, encourage employers to design larger projects than optimal for success under an ETP project.

Managing Projects

Benefits: Effective subcontractors and consultants can save monitoring staff time by knowing ETP procedures and providing needed documentation and information promptly.

Subcontractors and consultants help implement ETP policy changes by tracking changes and keeping employers up-to-date. Subcontractors and consultants can specialize and develop expertise in industries or types of companies, such as unionized companies, and become experts in the specialized issues that may apply to these companies, again potentially smoothing the way for project management.

Subcontractors have developed specialized software for tracking hours and other ETP related tasks, which again improves the efficiency of project administration.

Risks: Subcontractors and consultants may distort ETP policies and undermine effectiveness, by testing boundaries, seeking loopholes in order to serve existing clients or generate more profits. For example, through a tortured rationale, a subcontractor or consultant may force training into an ETP category where it does not really belong in order to get it funded. Subcontractors may deliberately limit contact between the employer and ETP staff in order to maximize their own value. This undermines ETP's ability to communicate with top management and insure that they understand ETP.

Finally, subcontractors and consultants may simply have wrong or old information. Many subcontractors and consultants do ETP projects only sporadically and may not keep up with changes in ETP policies, hence they may give employers bad information which will cause conflicts between the employer and project monitor later.

Delivering Training

Benefits: Today, even relatively large companies may have few or no in-house trainers. Training subcontractors and consultants can provide ETP programs with high quality state-of-the-art curricula, and trainers. Without training subcontractors and consultants, companies without an in-house training capacity could simply not participate in ETP. The competitive training market generates innovation in training as training companies compete with each other. This process saves ETP the cost of developing curricula and training trainers, all of which are costs borne by traditional training agencies such as the community colleges. Subcontractors and consultants have industry expertise which ETP staff could not develop.

Risks: Training subcontractors and consultants have an incentive to reduce the quality of training and hence its costs in order to reap larger profits. For example, a training subcontractor or consultant could substitute a less experienced instructor for a more experienced one, or standard curriculum for a customized one to save costs. This is particularly a problem if the subcontractor or consultant does not expect repeat business from the company.

Policy Process

Benefits: Subcontractors and consultants spend a lot of time working with employers and the ETP process, hence they have extensive and detailed knowledge of how ETP policies are operationalized in the field. Tapping this understanding, as this project tried to do,

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could provide the Panel with valuable information for policy development. Also, to the degree that subcontractors are representing the view of employers, they bring that perspective to the development of policy. As organizations and individuals who are dependent on ETP, at least in part for their living, they have some incentive to see ETP succeed and hence have effective policies.

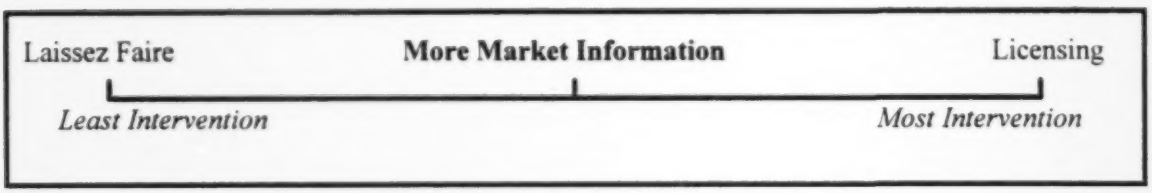
Risks: Once again, as profit driven entities, subcontractors and consultants are likely to try to manipulate the policy process solely for their own gain. Also, they may serve as advocates for a narrow group of employers, and overlook broader issues which the Panel must consider.

Recommendations

It seems to us, that given the current structure of ETP, subcontractors and consultants will remain a part of the program. The challenge for the Panel is to find policies that will enhance the benefits provided by subcontractors and consultants and to minimize the risks to ETP posed by their involvement.

The Panel is confronted with a continuum of policy options that range from laissez faire to aggressive intervention, with a host of options in between.

A Continuum of Policy Options



At one end of the continuum, the Panel could take a laissez faire approach. They could even do away with the existing regulations for subcontracts. At the other end of the continuum, the Panel could attempt to evaluate the qualifications of subcontractors and license approved subcontractors. In this case, only approved subcontractors would be allowed to work on ETP projects.

Given the substantial amount of public funds involved in ETP projects and the problems that have occurred with subcontractors and consultants, we cannot in good conscience recommend a laissez fair approach. On the other hand, given the complexities and legal problems of issuing licenses, and the reduction in competition caused by licensing, we cannot recommend such an extreme intervention.

Rather, we recommend a middle course. Our recommendations have two overarching goals: (1) to align the incentives that drive subcontractors and consultants with the larger objectives of the Panel and (2) to transform the inefficient market for ETP subcontractors and consultants into an orderly market. To accomplish these goals, we recommend that the

Panel act to increase the amount of information available about subcontractors and consultants, and take other steps to help employers make informed choices about subcontractors and consultants. In our view, increased information will make employers better consumers of subcontractor or consultant services, which should in-turn drive down the price of subcontractor or consultant services and improve the overall quality of subcontractors and consultants. Finally, all of this can be accomplished at a modest cost. Detailed recommendations and elaborated arguments for this strategy follow.

1. The Panel should provide employers with an easily accessible system of consumer information on subcontractors.

Our data show that both sellers (subcontractors and consultants) and buyers (employers) are operating in a inefficient market with little information. For a variety of reasons, employers are not shopping extensively for subcontractors and consultants. In fact, half the employers report they spoke to only one subcontractor before employing them. Despite the fact that most employers are satisfied with the subcontractors they chose, there is a substantial minority, probably between ten and twenty percent, who are dissatisfied with the subcontractors or consultants they hired and this group of employers tended to shop less than more satisfied employers.

As we noted in the beginning of the report, government often intervenes in inefficient markets to increase the amount and availability of information so that the market can function more efficiently. That is the course of action we recommend here.

Both employers and subcontractors viewed an information system as a valuable and legitimate activity for the Panel to undertake. In our survey, we asked both employers and subcontractors what they thought of the idea. Ninety percent of employers reported that information about subcontractors supplied by ETP would be valuable to them. Seventy percent of subcontractors report that such an system would be a "a good idea." Overall, both parties believed the situation would be improved by the availability of objective information about subcontractors.

We recommend the system focus on collecting data about subcontractors. Since most subcontractors also work as consultants at other times, the system will automatically provide data about most consultants.

We note that recently ETP staff have produced a spreadsheet with information about subcontractors who have worked on ETP projects in recent fiscal years. This is an excellent first step towards creating a consumer information system.

Information to be included in the system

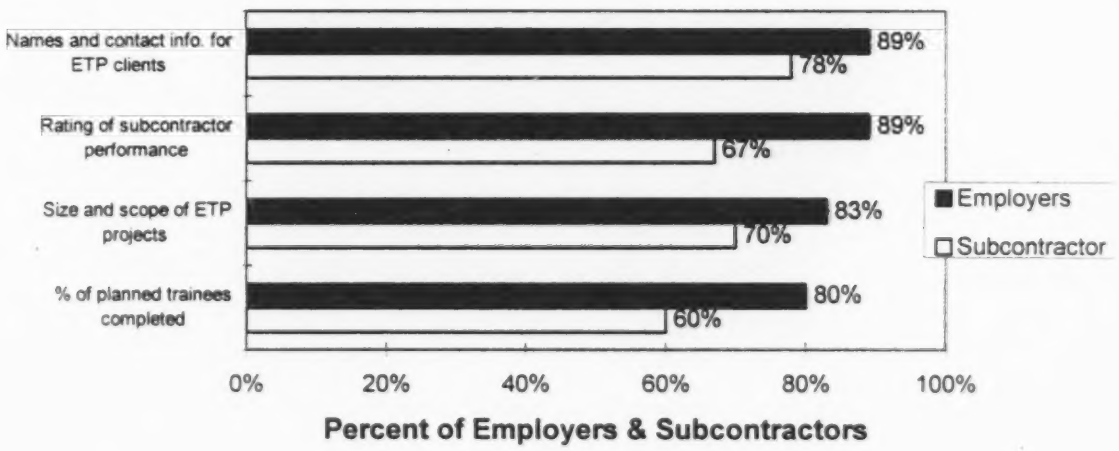
We recommend that the system include the following types of information:

- Name and contact information for all subcontractors who have been listed as subcontractors on ETP projects in the last three years.

- The names and contact information of ETP clients each subcontractor has had over the last three years.
- Descriptive information of the subcontractor's work on the projects, including: project size, industry, type of training or administrative services delivered.
- Information on the fees paid to subcontractors for services provided including: proposal development, administration, and training.
- Percent of planned trainees who completed training on each project.
- A rating of the subcontractor's performance by the employer.
- Subcontractor's attendance at recent ETP training sessions.

In our survey, we asked employers and subcontractors to rate how valuable they thought each type of data would be. The results show a surprising consensus. The chart below shows the percent of subcontractors and employers rating each item as very valuable or valuable.

Employers & Subcontractors Who Consider Information To Be Valuable Or Very Valuable



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The names and contact information of former ETP clients was rated highest by both groups. This basic information would allow employers to quickly contact former clients to get information on the subcontractors' performance and allow the employer to see how many clients the subcontractor has served in the last three years.

Information on the size and scope of previous ETP projects was rated as valuable by over 80% of the employers, but just 70% of subcontractors. Employers appear to be interested in this data, because they could see if the subcontractor had worked for employers similar to them. These data are readily available in existing ETP databases.

The percent of planned trainees completed was a more controversial item. Eighty percent of employers rated it as valuable, they saw it as a key indicator of subcontractor performance. In contrast, only 60% of subcontractors saw it as valuable. A number of subcontractors argued that the number of trainees completing was out of their control, as it is the employer's decision whether or not to release people to complete training. In our view, subcontractors are not solely responsible for planned trainees not completing, but in orienting employers to the ETP system, conducting needs assessments, and planning and administering projects, subcontractors do have a role in determining the proportion of trainees which will complete.

Employer's ratings of the subcontractors' performance was viewed as valuable or very valuable by almost 90% of the employers and 67% of the subcontractors. Typically, employers wanted to see answers to the types of evaluative questions they would ask a fellow employer if they called to check on a subcontractor's earlier performance. Some subcontractors resisted this item because they believed that if an employer was dissatisfied with the outcome of their ETP project, or frustrated with ETP's monitoring, they would blame the subcontractor and give them low ratings.

We asked both employers and subcontractors what aspects of a subcontractor's performance should be rated. Based on their response, interviews with ETP staff and Panel members, and our own experience with ETP projects, we suggest subcontractors' performance be rated in the following categories.[11]

Administration

- Knowledge of ETP policy and procedures in the proposal process.
- Knowledge of ETP policy and procedures in project administration.
- Reliability and professionalism: availability to employer, ethics, ability to work effectively with ETP staff.

Training Services

- Quality of training curriculum: sequence of material, appropriateness of the level of material, appropriate weighting of material.

[11] It is important to note that subcontractors will only be rated in areas where they provided services.

- Degree to which training was customized to the employer's needs.
- Performance of classroom trainers.
- Quality of SOST supervision.

Overall

- Degree to which training achieved expected results.
- If employer would use the subcontractor again for a similar project.

Collecting the Information

Except for the ratings of performance, the information we propose for the system is already collected in the ETP project file, it is just a matter of assembling it into an easy to understand format.

The rating information is new information. Both employers and subcontractors agreed that if such information is collected it should be collected by a third party, not ETP staff. We would recommend that whenever a project with a subcontractor closes, a third party under contract to ETP phone the employer and complete a brief structured interview to collect the ratings. It is important the individual collecting the ratings data talk to the most knowledgeable person on the employer's staff. In some cases, the interviewer may have to speak to more than one person to get complete ratings. To protect employers and insure that ratings are as frank as possible, we recommend that ratings not be posted by employers but rather that summary ratings be posted for subcontractors.

To insure a quick start-up of the system and reduce costs, we recommend that the system be phased in. In year one, three years of contact information and descriptive data from existing ETP records could be posted, but ratings data would only be collected for projects that closed in the last year. In each subsequent year, a new year's worth of ratings data would be added until three complete years of data were available.

Distributing the Information

The proposed system will only succeed if the data are put directly into the hands of employers as they're considering applying for an ETP project. To accomplish this, we recommend that the data be available on the ETP Web-site and that the availability of the data be broadly publicized in all ETP marketing efforts. In addition, we recommend that a paper copy of the data be included with each application package that is sent out to insure that at an early stage employers have the information they need to choose a subcontractor wisely. This is critical, since our data show 40% of the employers learned about ETP from a subcontractor or consultant, so many employers are in contact with a subcontractor or consultant from the very beginning of the process. The information may not be used to select a subcontractor in these cases but it will provide information to help the employer negotiate the best price they can.

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2. The Panel should develop a consumer guide to help employers choose subcontractors and consultants wisely.

ETP should develop a brief readable guide that will explain to employers why they may want to use or not use a subcontractor. If they choose to use a subcontractor, it should help them choose wisely by directing them to the new information system, suggesting that they consider more than one. It should also provide them with a list of questions to ask subcontractors before they hire them. Again, such a guide could be disseminated widely as part of ETP marketing efforts and be included with each application package.

In addition, the guide should help employers understand the real costs of ETP training. In other words, explain that ETP funding is not "free money." Rather the guide can emphasize that employers should spend the money as if it were their own. Illustrative budgets could quickly show employers the costs they will have to bear. The trade-offs between hiring a subcontractor to perform different tasks and keeping those tasks in-house could also be illustrated.

3. The Panel should provide semi-annual training for subcontractors and post attendance on information system.

To increase the level of information about ETP's shifting policies and practices, ETP should provide half-day training sessions once or twice a year, at each ETP local office, to keep subcontractors up-to-date about changes in ETP policies and practices. The training sessions can cover recent changes in ETP policy and day-to-day operations. It will give subcontractors a chance to ask questions outside the context of a dispute over a particular project and give ETP staff an opportunity to explain and clarify policies.

Attendance should be voluntary, but to provide an incentive for subcontractors to participate, ETP should post on the information system whether or not a company or individual attended ETP training. In the case of a company, the name and title of all the individuals who attended can be listed as well. This will provide an indicator to employers about currency of the subcontractor's knowledge and provide a regular method for improving communication between local offices and subcontractors.

4. The Panel should work with subcontractors to get advice and insights about issues related to ETP.

Our research clearly demonstrates that subcontractors play a major role in implementing ETP. Many subcontractors have developed substantial expertise in ETP and have a keen knowledge of how ETP policies and practices will affect employers in specific industries. We recommend that ETP tap this expertise by creating a "user group" of subcontractors from whom ETP can regularly seek advice and consultation. We are not suggesting that subcontractors be given a special role in shaping policy, but rather to use subcontractors to get feedback on the likely consequences of policy decisions that have been made on employers, and detailed suggestions for implementation.

Experience shows it is difficult to get busy employers to participate in these types of groups. Working with subcontractors will, to a degree, provide a method of tapping employer opinion, as subcontractors can speak for them in some situations.

These groups will also provide a channel to improve communication between staff and subcontractors and perhaps reduce the distrust which has come to characterize many of the interactions between subcontractors and staff.

5. **The Panel should consider how subcontractors and consultants shape the consequences of ETP policies, and conversely how ETP policies drive subcontractor and consultant behavior when developing policies.**

All public policies have the potential to generate unintended consequences which undermine the initial intent of the policy. For example, several years ago to reduce spending, ETP created a policy which required that if an employer applied for a second ETP project they would receive 30% less per trainee than in a first- time proposal. Responding to the incentives created by this policy, subcontractors advised the employers they worked with to increase the size of their projects to make sure every worker who might need training was covered. This led to an increase in the disencumbrance rate and a host of related problems.

Many other policy changes could reshape incentives for subcontractors and consultants thus changing their behavior. Since a large number of employers get their information about ETP from subcontractors and consultants, it may change their behavior as well in unintended ways. In developing policies, staff and the Panel should use their understanding of subcontractors and consultants to reason through the likely consequences of policies for subcontractors and consultants and shape policies accordingly.

Appendix A:

Estimates of The ETP Training Market
and
The ETP Subcontractor and Consultant Market

The ETP Created Market for Training

ETP has expanded the market for training in California through its payroll-based tax and subsequent expenditure of those monies on training. Because these funds are released through training contracts with employers or other principals rather than through state-provided training, the ETP expenditures constitute an addition to the market for private training in California. Private training can be provided though training specialists either employed by the ETP contractor or through independent training specialists who contract with the principal to provide the training. In this way, the ETP training funds create or expand the market for private training specialists in California. The presence of ETP expands the market both for people who directly deliver training (of the type permitted and encouraged by ETP) and for people who administer training projects. While this study focuses on independent subcontractors who contract to deliver ETP funded training and administrative services, it is important to remember that a training program that is implemented completely by the employer's staff still requires training and contract administration services and therefore expands the market for private training delivery and administration in California.

In this estimate of the expansion of the market for private training professionals created by ETP funding our analysis includes all of the 394 ETP training contracts during the 1994-95 and 1995-96 fiscal years. The contract database for this market impact analysis is 394 contracts rather than the 260 contracts used to develop the descriptive statistics presented in Table 2 in the text.

ETP approved $145,140,000 in the 394 original training contracts during the 2 study years and, initially, that would seem to be a good estimate of the expansion of the private training market in California due to the presence of ETP. However, the training market impact estimate is complicated by several factors. The contract amount was amended downward during the course of the contracts to $136,725,000, and the amount actually earned by the contractors during the 2 year period was only $74,985,000, about half the amount originally approved. The true impact of ETP on the training market probably lies in the low end of the broad range between the $74,985,000 in ETP funds actually earned by contractors and the $136,725,000 in the amended contract amounts.

There are several considerations that influence the likely level of the impact of ETP within this range. Beginning at the low end of the range, factors that suggest a higher estimate include:

- ETP contract funds are disencumbered because the proposed training did not even begin in most cases, but about 20% of the disencumbered funds are associated with training that begins but is not completed for some reason (according to staff estimates). To the extent that some training takes place even though the funds are disencumbered, the ETP's estimated impact on training will be higher.

- About 40% of the ETP contractors surveyed said that ETP funds covered only about 72% of their direct costs of training (which do not include the wages of the trainees)

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because they wanted a higher quality of training than the fixed fee would allow. Fixed fees were used in contracts that accounted for 80% of the dollar volume of earnings. This suggests that ETP's impact on training will be higher than their direct expenditure on training.

A couple factors argue for a lower level of ETP impact than the top end of the range:

- The amendments that reduce the original level of the contracts and the disencumbrances from the contracts are used to fund new contracts. If all of the original contract amounts were spent on training by ETP, less would be available for future contracts. That is, if no monies had been amended out of contracts or disencumbered, ETP could not have written over $135 million in original training contracts during the 2 year period because they did not have access to that much money.

- To the extent that some of the training financed by ETP would occur even if ETP did not exist, the impact of ETP on total training is less. This would be the case even if a project that was financed by ETP would only have been privately undertaken at a much reduced level and scope. In this case, ETP still expands the private training market but only by the amount of the difference between the value of the training that would have occurred without ETP and that which did occur in the presence of ETP.

The large estimated range of ETP's impact on the training market is not very satisfying and argues for some refinement of the estimate. To develop a more precise estimate, we begin with the amount actually earned in the contracts and then adjust for most of the factors listed above.

The amount earned in ETP contracts:	$74,985,000
Adjustment for 20% of disencumbered funds actually involving training, assuming the training is 50% completed on average:	$6,175,000
Adjustment for ETP fixed fee under-funding desired training, 40% of surveyed contractors reported 72% funding of direct training costs applied to fixed fee contracts which were 80% of the total dollar volume:	$5,150,000
Estimated 2 year impact of ETP on Direct Training Market:	$86,310,000

This estimate does not include an adjustment which nets out the value of the training that would have been done in the absence of ETP. For example, if 20% of ETP funded training would have been done in the absence of ETP, the estimate of ETP impact on training would be reduced to less than $70 million. Such an estimate is far beyond the scope of this

study. However, ETP can help maximize its overall impact on training in California by vigilantly avoiding paying for training that would have occurred in any case.

The Market for Subcontractors and Consultants

The focus of this part of the study is the extent and nature of the market for independent training and administrative subcontractors and consultants spawned by ETP contracts. Unfortunately, the overall extent of the market for subcontractors and consultants created by ETP funding is not immediately apparent from the available ETP data for two reasons.

First of all, ETP collects contract information which includes only formal subcontracts for training and administration of the project, which we call subcontractors. It is well known by ETP staff and others that there have been consultants working with the contractors who have not shown up in ETP contract information; these are the consultants and their share of the market is difficult to estimate. Secondly, the ETP subcontract data are not adjusted for subsequent disencumbrances. An estimate of the market for subcontractors and consultants requires an adjustment procedure similar to the one developed for the ETP training market impact.

In the following sections, the administrative and training subcontractor markets are estimated based on the original contract information; then the administrative and training consultant markets are estimated on the same original contract basis and data from the employer survey. Finally, the subcontractor and consultant market estimates are adjusted to reflect disencumbrances and underpayment in fixed fee contracts.

The Market for Subcontractors (not adjusted for disencumbrances and fixed fee contracts).

Our analysis of the 394 contracts yielded the following facts:

- A total of 272 contracts (or 69.0%) of the 394 ETP contracts had reported training and/or administrative subcontractors.
- These 272 contracts with subcontractors accounted for $79,925,000 (or 58.5%) of the $136,725,000 in total amended ETP contracts over the two-year study period.
- The dollar amount of the subcontracts with reported consultants and subcontractors in these ETP contracts was $41,095,000, which was 51.4% of the allocation in these 272 contracts, and 30.1% of ETP's total contract allocation over this period.
- Training subcontracts were found in 251 of the 272 contracts with subcontractors and totaled $36,535,000 or 52.9% of the average contract that had training subcontractors.
- Administrative subcontracts were found in 127 of the 272 contracts with subcontractors, and totaled only $4,560,000 or 10.0% of the average contract that had administrative subcontractors.

- Training subcontractors clearly dominated the market both in terms of prevalence and dollars funded. Of the 272 contracts with subcontractors, 251 reported training subcontracts. The total dollar allocation on training subcontractors was $36,535,000, which was 88.9% of the allocation to subcontractors and 30.1% of total ETP original contract amount over the period. Administrative subcontractors accounted for $4,560,000, which was 11.1% of the subcontractor allocation and just 3.3% of the total ETP approved contract funding over the period.

On the basis of the amended contract funding, the potential market for subcontractors is:

Training subcontractors:	$36,535,000
Administrative subcontractors:	4,560,000
Total subcontractor market:	$41,095,000

The Market for Consultants (not adjusted for disencumbrances and fixed fee contracts).

We derived the estimate of consultants from the survey of 1995-96 contractors who did not report any subcontracts (subcontractors) in their original contracts or subsequent amendments. We interviewed 37 contractors out of the 38 contracts that showed no subcontractors to determine whether they had hired consultants who were not reported in the ETP contract. The 38 contracts in 1995-96 can be viewed as a random sample of the 122 contracts without reported subcontractors during the two year period. Selecting recent contracts should not introduce any systematic bias into the sample and it certainly made it easier to gather specific information about the contract. The respondents indicated that:

- Some type of consultant was used by 35.1% (13 out of 37) of the contractors.
- Training consultants were used by 24.3% (9 out of 37) of the contractors.
- Consultants to help develop the ETP proposal were used by 21.6% (8 out of 37) of the contractors.
- Administrative consultants were used by 10.8% (4 out of 37) of the contractors.
- Administrative and/or development consultants were used by 24.3% (9 out of 37) of the contractors.
- A person with ETP contract experience was actually hired on staff in 2 contracts to implement the training contracts.

For estimation purposes we grouped the consultants who helped develop the proposals with the administrative consultants because information gathered in the focus groups and the subcontractors' survey suggested that a common responsibility of an administrative

consultant is the development of the contract proposal. We then applied these percentages to the 122 contracts in the 2 year period that did not report using subcontractors. The two contracts under which an ETP-experienced professional was hired on staff were not counted in this estimation. The final estimates below would be higher if the hired professionals were considered to be "consultants" and included in the estimates.

The first step in the estimating procedure is to determine the likely number of contracts during the period that had consultants. This entails applying the sample percentages to the population of 122 contracts without reported subcontractors.

Estimate of the number of contracts with training consultants:
(24.3%) X (122 contracts) = 30 contracts

Estimate of the number of contracts with administrative consultants:
(24.3%) X (122 contracts) = 30 contracts

Estimate of the total number of contracts with consultants:
(35.1%) X (122 contracts) = 44 contracts

Our analysis of the specific contracts that reported consultants indicated that the average size of these contracts was substantially smaller than that of the group of contracts without reported subcontractors. The average size of those with consultants was $295,000 or 63.3% of the overall average for the group without reported subcontractors ($466,000). This means that the likely dollar amount paid to consultants was smaller than the estimated proportion of contracts with consultants would suggest.

This smaller size for the contracts involving consultants relative to the average contract is consistent with the results among the reported subcontractors versus the no-subcontractor group. The average size of a contract with subcontractors was 71.4% of the average size of contracts without subcontractors.

We assumed that the consultant contracts had the same proportion of the original contract amount designated for consultants as did the subcontractor contracts; that is 52.9% for training and 10.0% for administrative consultants and subcontractors. We accounted for the smaller average size of contracts with consultants by using the average size of consultant contracts ($295,000) in the calculation. These assumptions yielded the following estimates for training and administrative consultants:

Estimated training subcontract dollar amounts:
($295,000) X (52.9%) X (30 contracts) = $4,682,000

Estimated administrative subcontract dollar amounts:
($295,000) X (10.0%) X (30 contracts) = $885,000

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Estimated Total Consultants Market during fiscal 1994-95 and 1995-96:

	Subcontractor	Consultant	Total:
Training:	$36,535,000	$4,682,000	$41,217,000
Administrative:	4,560,000	885,000	5,445,000
Total:	$41,095,000	$5,567,000	$46,662,000

At this stage, the total estimated consultant payment amount is $ 5,567,000. As explained above, this amount does not reflect adjustments to the contract amount through the amendment process or due to disencumbrances. Nor does it include adjustments for the underpayment of direct training costs reported by 40% of contractors who claimed ETP contract payments only covered 72% of their direct training costs. These adjustment are made in the next section.

The Overall Market for Subcontractors and Consultants: Adjusted for Disencumbrances and Fixed Fee Under-funding.

Our estimate of the post-disencumbrance market for consultants and subcontractors takes the same basic approach as our estimate of the ETP-created market for training, but we factor in some unique features of consultant-contractor relationships. We begin with the estimate of the total dollar amount in approved contracts that was earmarked for either consultants and subcontractors, then discounted by the average disencumbrance rate for the contracts in the sample. The result of that calculation is adjusted to account for training that actually occurred but for which the funds were disencumbered anyway. The final estimate of the market for consultants and subcontractors for ETP contracts is a range based on alternative assumptions regarding consultant-contractor payment agreements.

The average disencumbrance rate in contracts with subcontractors at 51.4% was virtually identical to that for the sample contracts with consultants (51.6%). We used the 51.4% discount factor since it applied to many more contracts. Applying the average discount factor of 51.4% yields:

Training contracts:	$41,217,000 X 48.6% =	$20,031,000
Administrative contracts:	$5,445,000 X 48.6% =	2,646,000
Fully discounted total consultant estimates:		$22,677,000

As before, we assume that training actually occurs in 20% of these cases where funds were disencumbered, only in this case we assume that the training and administrative consultants and subcontractors get paid in full for the portion of training that occurs: This calculation adds back in 20% of the estimated disencumbrances in the preceding calculation.

In this estimation, we also adjust for the under-funding of direct training costs reported by 40% of the contractors who were under fixed fee contracts. These 40% reported that the fixed fee covered only 72% of their direct costs of training. Training subcontracts with fixed fees accounted for 87.7% of the dollar volume of training subcontracts and administrative subcontracts with fixed fees accounted for 81.7% of the dollar volume of administrative subcontracts. These percentages yield an additional factor of 13.7% for the training consultants and subcontractors and 12.7% for administrative consultants and subcontractors.

Adding back in the 20% of disencumbrances and the fixed fee adjustment factors yields our minimum estimate of the subcontractor and consultant market.

Training contracts:
adjustment for disencumbrance: $20,031,000 + (.2 X $21,186,000) = $24,268,000
+ adjustment for underpayment: $24,268,000 + 13.7% = $27,593,000

Administrative contracts:
adjustment for disencumbrance: $2,646,000 + (.2 X $2,799,000) = $3,206,000
+ adjustment for underpayment: $3,206,000 + 12.7% = $3,613,000

Minimum estimated subcontractor and consultant market
for the two-year study period: $31,206,000

Information from our subcontractor focus groups and our surveys of subcontractors and employers led us to believe that subcontractors and consultants are actually paid more that the preceding calculations suggests. Our conversations in the focus groups with subcontractors suggested that very little risk-sharing was undertaken by subcontractors and consultants, particularly training subcontractors and consultants. Trainers were paid the contract amount even if the classes were only half full. Following this logic, we calculated an upper estimate of actual subcontractor payments based on the assumption that subcontractors were paid the full amount of their agreement for any project that disencumbered less than 50% of its funds. The remainder of the subcontractor contracts (those with >50% disencumbrance rate) were discounted by the disencumbrance rate actually experienced. Applying these factors to the reported subcontracts for training and administrative subcontracts, we determined that, under these assumptions, training subcontractors would have earned 67.7% of their original contracted amount and administrative subcontractors would have earned 51.3% of their original contracted amount. We applied these rates to the total estimated amount for subcontractors and consultants and obtained the following estimates for the high end of our range.

Training contracts: $41,217,000 X 67.7% = $27,904,000 [+ 13.7%] = $31,727,000
Administrative contracts: $5,445,000 X 51.3% = 2,793,000 [+ 12.7%] = $3,148,000
Maximum estimated subcontractor and consultant market
for the two-year study period: $34,875,000

Our estimate puts the ETP-generated market for training and administrative subcontractors and consultants at roughly between $31 million and $35 million for the two-year study period. This estimate pertains to the entire market for subcontractors and consultants engendered by the full range of ETP contracts for the two years (the 394 contract database), and not just the subcontractors associated with ETP contracts with single employers (the 260 contract database).

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